INDUSTRY VIEWS

The regulation, taxation and distribution of hedge funds in Europe
Changes and Challenges

June 2006, 4th Edition

Contents

This paper was prepared with input from the hedge fund specialists of PricewaterhouseCoopers' Global Alternative Investment Management Industry Group. Compilation of such a paper, which covers up-to-the-minute developments across many countries, requires a high degree of cross-border collaboration and thanks are due to the PricewaterhouseCoopers international network for their input.

While this information represents our understanding at the time of going to press, given the rapid pace of change in the European hedge fund industry, the factual data in this paper may quickly be superseded. Up-to-date advice should always be obtained regarding current regulations and fiscal rules.

Foreword

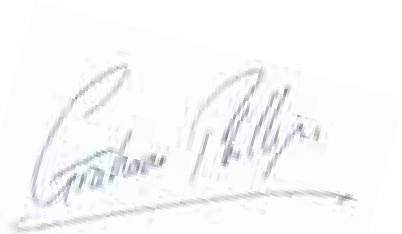
I am pleased to present the 2006 edition of our report on the Regulation, Taxation and Distribution of Hedge Funds in Europe. The report includes a detailed consideration of the various national regulatory and tax regimes as they affect hedge funds, hedge fund managers and hedge fund investors across the marketplace in Europe.

This is the fourth year that we have produced this report, which represents a key part of PricewaterhouseCoopers' commitment to thought leadership in the European hedge fund industry.

Recent surveys and industry statistics support the trend of an increased demand for absolute return strategies from institutional investors. We believe that absolute return strategies will become a recognised ingredient within all investment portfolios. Similarly, changes made by certain national regulators and fiscal authorities have continued to facilitate greater access to hedge funds and hedge fund-like products; in some territories, restrictions on access by retail investors have been eased.

As institutions allocate more funds to absolute return strategies, we believe that hedge fund managers will be faced with a choice: do they align themselves with the large asset managers, who act as a distribution channel to institutional money and therefore seek to comply with an institution's (and their adviser's) demands for transparency, strong governance and a robust operating environment? Or, do they choose to remain focused on the high net wealth sector, which allows more flexibility in the standards of operations? This is a choice for each hedge fund manager. Recent market activity demonstrates that certain hedge fund managers are choosing to build their businesses by winning mandates to manage institutional money and either joint-venturing or being acquired by more traditional asset managers.

What is clear is that, however the marketplace segments in the future, there is ever-increasing focus on the underlying product by both regulatory and tax authorities; as capital continues to flow into the hedge funds marketplace, this should not be a surprise. The regulators are concerned about governance and valuation, as well as any systemic risk in the financial markets that mirrors their oversight responsibilities relating to investor protection and orderly markets. During the past year there has been an unprecedented increase in the number of discussion papers, consultation papers and committees reviewing the industry; such activity results in new rules and a number of territories have changed their regulatory or tax regimes. Hedge fund manager's and promoters need to continue to focus on shaping and influencing industry standards before it is imposed upon them.



Graham P.N. Phillips
European Hedge Fund Practice Leader
Partner, PricewaterhouseCoopers LLP
London
June 2006

Section 1

Current developments in the hedge fund market

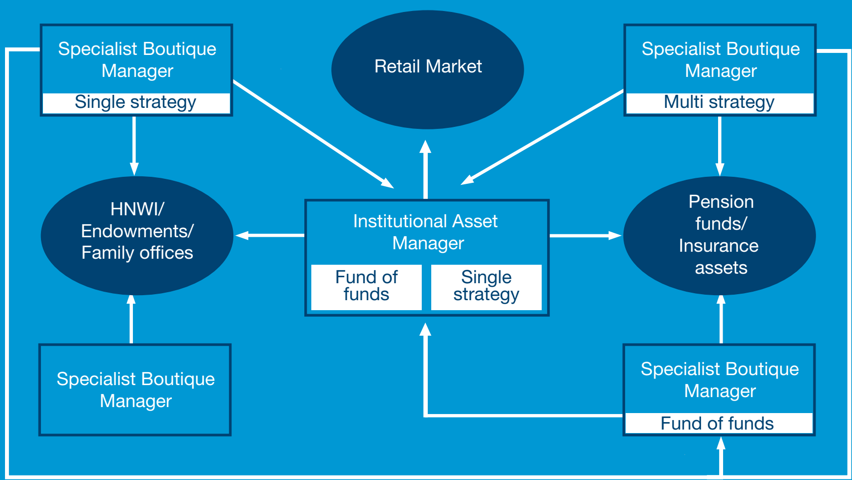
Growth in the hedge fund sector remains strong with interest from the whole spectrum of investors: institutional to retail. More conservative estimates of hedge fund assets under management currently assess the market around the USD1.1 trillion mark.

Increasing asset allocations made to hedge funds by large institutional investors should mean that 'best of breed' funds (and their managers) will find it easier to increase assets under management compared to the smaller boutique specialist managers. Institutional investors and their advisers have an onerous responsibility – they are responsible and accountable for other investors' money. Necessarily, such institutional investors will search for funds that are characterised by more than a track record of alpha generation – they will seek to ensure good governance practice and high standards over the management of non-investment, or operational risk.

The marketplace appears set to polarise into those hedge fund manager groups that want access to institutional money and those more specialist managers, that want to access the more traditional type of investor – high net-worth individuals, family offices and endowment funds.

Various business models are being put forward to capitalise on the opportunities being offered by institutional money. These range from alignment of interests (preferred supplier-type arrangements and white labelling) through to joint-venturing arrangements or outright acquisition. Recent market acquisition activity demonstrates that traditional asset managers are recognising that hedge fund managers have a talent or competence that they require in order to offer a complete suite of products to their institutional clients. The traditional asset manager brings distribution channels, infrastructure support, significant seed capital capabilities and where there is an acquisition, access to tradeable (normally listed) stock with which to reward fund manager's talent.

Accessing pools of funds:



These developments appear to offer a 'win-win' scenario, but it remains to be seen whether these business models can achieve all that is anticipated. It must not be forgotten that the asset management industry is a people business and that a key reason for the establishment of many hedge fund managers as boutique operators was to achieve distance and autonomy from the bureaucratic environment of a large financial institution.

The developments in business models are matched by the evolution of new investment strategies in Europe, previously only seen on the other side of the Atlantic: for example funds are being established to provide loan origination, trading of carbon credits and other commodities, investing in reinsurance assets and investing in transactions that were previously the domain of private equity houses.

The impact of the regulators on the marketplace must not be underestimated. The movement of capital into the hedge fund area was bound to attract their attention.

In the past year, regulators have elaborated on their concerns that hedge funds create systematic risk to financial markets. The views of individual regulators vary, but, at present, it is clear that there is little appetite to create new regulations specifically focused on hedge fund managers. Indeed, the UK's FSA has noted the important role that hedge funds play promoting market efficiency and, at this stage, is only proposing enhanced data collection with a view to monitoring, assessing and understanding the influence of hedge funds on financial markets.

Certain national regulators remain more fixated on product regulation and are developing new regulatory product classifications that typically demonstrate a positive correlation between restrictive investment and borrowing powers, and the ease of access by retail investors.

Choice of investment strategy does not only affect the regulatory categorisation of the fund and therefore to whom it can be distributed, but also the tax treatment of the fund. Thought is required at the development phase to ensure that an appropriate tax structure is put in place to achieve optimal tax treatment at the level of the fund and of investors. The chosen structure must be capable of withstanding challenge from fiscal authorities who, like their regulatory counterparts, are showing an increasing understanding of, and interest in, the hedge fund sector. The tax risks attached to individual strategies vary considerably. However, with some of the new fund strategies that are emerging, the risk of creating a taxable presence in an onshore EU jurisdiction is significantly increased.

That said, Europe remains a diverse place and regulations, fiscal rules, or a combination of both, still limit individual investors' participation in the sector, with the degree to which access to hedge funds and hedge fund-like products being dependent on which set of national rules applies to each investor and to each fund.

While the regulators are responding to increased demand, the fiscal authorities still need to catch up. Recent European Court of Justice cases, in respect of VAT for example, show an inclination towards non-discrimination between the treatment of one type of fund over another. If this trend continues, fiscal authorities may have no choice but to accelerate legislation that clarifies their position on the various types of vehicles that exist.

Another effect of regulators' interest in the sector is the increased recognition by hedge fund boards of directors of their responsibilities to shareholders and the attention that they need to pay to governance arrangements, particularly with regard to their monitoring of the services provided to the fund by third parties, including the investment manager, and the relative robustness of fund valuations and NAV calculations. Given that failure to control operational risk has contributed to many hedge fund failures, this is an encouraging sign and one that will no doubt be applauded by investors, who are naturally concerned that there should be responsible stewardship of their money.

Hedge fund managers and promoters continue to have an important role to play in shaping the future regulatory landscape: responses to regulators' calls for consultation have clearly influenced regulators' thinking and we expect that a collaborative approach will continue to yield benefits for the industry at large.

Pan-European regulatory developments

The pan-European picture

Against a backdrop of growing scrutiny of the hedge fund section by the US Securities and Exchange Commission (SEC), which has culminated in a requirement for registration affecting many hedge fund managers (whether domiciled in the US or not), European regulators have been demonstrating an increased interest in the sector.

Many of the pan-European regulatory bodies are actively engaged in 'getting to grips' with the subtleties surrounding the hedge fund market. Helpfully, comments emanating from these organisations indicate a lack of appetite to bring about the introduction of prescriptive rules for hedge funds as a product and focus instead on secure oversight of the fund via the investment managers. Yet it remains to be seen whether the apparent preference for focusing on self-regulation over the operation of the fund, for example by promoting the adoption of voluntary codes, is a true reflection of a desire to allow the entrepreneurial flair of the sector to flourish, or whether it masks a lack of confidence by pan-European regulators about their ability to understand correctly the risks and rewards inherent in the sector.

In August 2005, the European Central Bank issued an 'occasional paper' entitled 'Hedge Funds and their implications for Financial Stability', which made heavy reference to the near-collapse of LTCM and the effect that this had on markets. The paper outlined both the positive impacts of hedge funds, for example by providing diversification benefits for investors, and negative effects such as potential exposure issues for prime brokers and banks, and concluded that regulators must increase their knowledge of the impact of hedge funds on financial institutions and financial markets.

Separately, the International Organisation of Securities Commissions (IOSCO) is in the early stages of developing a code of practice for hedge fund valuations and pricing. A global committee of 16 (with membership split equally between regulators and industry) has been established to consider the principles drafted by IOSCO that would underlie the code.

A further paper is expected to be released by June 2007.

The European Commission (EC) is getting in on the act too: its green paper on 'Enhancing the European Framework on Investment Funds' touched briefly on alternative investment funds and recognised the need for a separate group to be established to consider such funds in more detail. Subsequently, an expert group has been created, which has been tasked with producing a report examining the current position of European hedge funds and identifying the barriers to the development of the sector on a cross-border basis. This report is due to be published in late June 2006.

At a national level, the Dutch and UK regulators have been particularly active in considering the hedge fund sector, with several important papers being issued over the past year. As a member of both the Committee of European Securities Regulators (CESR) and IOSCO, the views of the Dutch regulator (the Netherlands Authority for the Financial Markets – AFM) are of interest, not only to those active in the Dutch market, as an indicator of future regulatory change. The AFM's views will inevitably assist other regulatory authorities in forming their respective responses to the growth in hedge funds, particularly if they are well researched and articulated. With London still home to the vast majority of European hedge fund managers as well as an ever-increasing number of US and Asia-based managers, the role that the UK's FSA can be expected to play in shaping the future regulatory environment can also be expected to be significant. We note, in particular, the FSA's stated interest in conflicts of interests and their recent comments about retailisation of hedge funds and hedge fund products. We consider the view from both countries in more detail in the case studies on this page.

Against the background of increased regulatory activity, both at national and pan-European levels, it seems unlikely that European hedge funds and their managers will escape significant regulatory scrutiny. It remains important for market participants to continue to ensure that their voices are heard by responding to regulators' consultations, whether on an individual basis or via representative trade bodies.

Case study 1: The view from the Netherlands

Over the last year, the AFM has been engaged in undertaking a review of the hedge fund market, concentrating on the conduct of business aspects of their operation. Hedge funds are a fully regulated product in the Netherlands (which is not the case in many other European jurisdictions) and are treated in the same manner as any other funds with respect to distribution, so the AFM's position may well be instructive of how the regulatory framework in the rest of the European marketplace develops in due course.

An initial position paper, for which comments were invited by November 2005, sought to set out specific issues and risks relating to the conduct of business perspective. While one may or may not agree with all the postulations, the paper makes interesting reading due not least to the fact that the AFM has actually attempted to define what a hedge fund is!

The AFM's definition dispels some of the more often quoted misconceptions of hedge funds and instead concentrates upon the investment strategies employed as a means to differentiate hedge funds from traditional long-only funds. If this approach is adopted by other regulators, the emergence of common regulatory standards of oversight may happen faster than one may first imagine.

Case study 2: The FSA's response to the market

In March 2006, the FSA issued its feedback papers following consultation on its 2005 discussion papers relating to hedge funds and hedge fund managers (entitled 'Wider-range retail Investment Products: consumer protection in a rapidly changing world and 'Hedge funds: A discussion of risk and regulatory engagement').

The feedback papers demonstrate the UK regulator's sensitivity to the commercial impact of imposing additional regulatory burdens upon hedge fund managers. London remains home to the majority of Europe's hedge fund managers and there is no desire to see this change. For the time being at least, rather than prescribing new regulations focusing on hedge fund managers, the FSA has taken a pragmatic approach, which is limited to increasing data collection from hedge fund managers, identifying areas for further focus (such as asset valuation and side letters) and concentrating its approach to the sector on the largest 25 hedge fund managers operating in the UK. A dedicated supervisory team has been set up by the FSA to oversee the hedge fund industry in the UK and this team will play a major role in analysing the additional data that will be obtained as well as in performing themed visits, particularly at the largest firms.

Separately, the FSA issued a new consultation paper in March 2006, entitled 'Implementation of the Transparency Directive/Investment Entities Listing Review'. The latter part of this paper proposes a mechanism by which 'wider-range' investment products could enter the retail market in the form of vehicles listed on the main market of the London Stock Exchange (LSE). Such funds would, of course, be subject to the corporate governance requirements applicable to all entities listed on the main market. The consultation period closes on 30 June 2006.

Trends in governance

In Europe, the operational model for hedge funds which has developed as a de facto standard, differs from that often adopted in the US, as European hedge funds typically appoint a third party administrator to maintain the fund's books and records and handle the subscription and redemption requests of investors.

Certain commentators have expressed the view that the existence of a third-party administrator is a large part of the reason why scandals involving mis-reporting of hedge funds' net asset values are less prevalent in Europe than in the US. While this view is not inconsistent with the facts, it is perhaps an oversimplification: in reality, there is considerable variation in the manner in which third-party administrators value hedge funds' investment portfolios.

This variation arises from differences in:

- the governance frameworks (if actually prescribed and applicable to the individual fund's domicile);
- the nature of regulation to which administrators are subject in their various territories;
- the nature of instruments being traded by individual hedge funds; and
- the willingness of administrators and hedge fund managers to put in place a 'NAV-Lite' administration arrangement.

There is increasing agreement within the industry that such 'NAV-Lite' arrangements, whereby an administrator either accepts prices supplied by the investment manager at face value as being appropriate for inclusion in the fund's NAV or subjects them to little scrutiny and corroboration, does little to help the industry's image. Industry groups such as AIMA are taking the lead in bringing the issue to the fore and seeking solutions that are not overly costly or burdensome, allowing hedge fund managers the ability to continue to focus on what they do best: managing the money.

Self-regulation is generally the preferred solution of European Regulators to their investor protection concerns and especially, in the light of the possibility of a significant retail sector developing, the industry is to be encouraged to continue its efforts to adopt codes of conduct. Pricing remains a key area where a code of conduct is, in our opinion, vital.

At the same time, institutional investors are increasingly using their purchasing power to influence hedge fund managers to produce an independently-verified Report on Controls under a recognised framework (such as the USA's SAS 70 and the UK's FRAG 21 and new AAF 01/06), and to appoint an administrator which also produces a Report on Controls, in recognition that hedge fund failures tend to stem from failure to manage operational risk in an appropriate manner, rather than a failure of the investment strategy.

Given increasing consolidation of hedge fund managers and of hedge fund administrators, we expect that the preparation of such a report by managers and administrators will become at least a unique selling point, and possibly even a prerequisite for raising money from the more savvy institutions going forward.

For funds adopting a corporate structure, the board of directors has a fiduciary responsibility to investors: it is the board that investors will look to in the first instance if they are defrauded or disadvantaged on entering/leaving the fund, due to errors in pricing or other processes. In certain domiciles, for example Ireland, responsibility for valuation is delegated to a custodian (which may or may not be an affiliate of the administrator). In other domiciles, delegation of the authority to calculate and approve the NAV to an administrator and/or the hedge fund manager is unlikely to provide a robust defence to the board in the event of a claim in relation to a pricing error.

Boards should therefore be fully cognisant of the regulations to which their administrator is subject and the ability of their administrator to independently price the instruments traded by the fund. They should pay particular attention to the extent to which the hedge fund manager is involved in determining the prices to be applied by the administrator to individual instruments held by the fund.

The increase in the size of the market for hedge fund administration services, combined with consolidation among service providers, has seen administrators seeking to differentiate themselves by offering new services using sophisticated technologies, designed to tempt hedge fund managers into recommending an administrator be appointed. Boards would be well advised not to be overly distracted by these 'add-ons' and to concentrate their own pre-appointment due diligence on the basics, i.e. on how the administrator can support good governance by the board.

A pan-European authorised hedge fund product?

The introduction of the amendments to the UCITS Directive in 2004 (UCITS III), for the first time enabled derivatives to be used as investments in their own right within a UCITS fund. However, little guidance was initially produced as to the admissibility or otherwise of certain specific derivative instruments or indices of hedge funds. CESR has grappled with this issue ever since and in January 2006 produced its final advice to the EC regarding eligibility of certain assets for investment in UCITS.

UCITS schemes can now invest in derivatives providing the underlying assets do not circumvent the requirements of the UCITS directive as to eligibility. In other words, using a derivative to mask exposure to non-eligible assets is not permitted. UCITS can run long/short strategies (providing the short derivative position is cash settled) and can invest in Collateralised Debt Obligations. Indeed credit derivatives are specifically mentioned by CESR as a mechanism both to reduce risk and to add risk to a portfolio, depending upon the manager's preference. Consequently, there is scope for a range of hedge fund-type strategies to be employed within a UCITS fund.

However, CESR was also specifically asked to consider the eligibility of hedge fund indices within a UCITS fund, and eventually decided that these were inadmissible. Therefore, while a UCITS fund can invest in a commodity or property index via a financial derivative, it cannot (yet) gain direct exposure to a hedge fund index.

Today, a UCITS fund can therefore employ a wide range of strategies that are very similar to those of hedge funds and, via the purchase of a listed security embedding a hedge fund-like strategy, can in fact achieve far greater exposure than perhaps initially envisaged by the Commission as appropriate for retail investors.

CESR's advice still has to be transposed into EC law. In the meantime, some countries are using the advice as a working checklist, while others are maintaining conservative interpretations.

Coming soon

The impact of MiFID

All EU-domiciled Investment Services Directive (ISD) firms are within the scope of Market in Financial Instruments Directive (MiFID). However, boutique hedge fund managers, particularly those that outsource the majority of their compliance function, may feel the additional compliance burden associated with the rules coming in under this new EU Directive to a greater extent than larger ISD firms (whether or not these manage hedge funds), which typically have dedicated compliance departments and more well-developed policies and procedures.

We expect that the introduction of MiFID will bring more formality and rigour to the organisation of hedge fund managers; detailed rules on risk management, compliance and management of conflicts, allow proportionate implementation but are, nonetheless, prescriptive.

Conflicts policy, in particular, may cause some 'head scratching'. Conflicts must first be identified, and then addressed by removing them if this is possible. Where removal is not possible, as a last resort, conflicts may be addressed by way of disclosure to investors.

Additionally, hedge fund managers and certain administrators (for example, those that are regulated as ISD firms by virtue of providing transfer agency services) should not overlook the requirements in MiFID in relation to 'critical' outsourcing arrangements. The relevant provisions of the Directive are not yet final, but the indications are that the compliance implications of outsourcing outside the European Economic Area (EEA), including outsourcing to subsidiaries or branches of EEA entities that are located outside the EEA, will become more onerous.

Boards of directors of hedge funds may well seek to take advantage of the changes brought about by MiFID by asking their investment managers to report periodically on those matters covered by MiFID which impact on the board's fiduciary responsibilities. For example, the board may wish to gain comfort that: the investment manager has appropriate policies and procedures in place to identify conflicts of interest between the hedge fund and other clients of the manager; conflicts have been eliminated where possible; and conflicts that cannot be eliminated have been appropriately mitigated and fully disclosed.

MiFID will also bring changes in market practice. More trades will be disclosed to the market, new market venues will appear and liquidity will shift from one venue to another. It is difficult to predict the scale of these changes in advance, but the fact that they are seen as strategic challenges by the investment banks may mean that they offer trading opportunities for hedge funds.

Changes to prudential requirements

Hedge fund managers operating in the EEA are currently required by their regulators to comply with local capital adequacy rules based on the EU's Capital Adequacy Directive (CAD). These rules are due for a major update as a consequence of the impending implementation of the Capital Requirements Directive (CRD), which will effectively replace the CAD, commencing on 1 January 2007. The new local rules are expected to vary less significantly than the current CAD-based rules and, given London's position as the dominant centre for hedge fund management in Europe, we have concentrated in the analysis below on the nature of the new rules expected to be implemented in the UK.

In February 2006, the FSA issued its final consultation on the rules to come into force on 1 January 2007. This included draft transitional provisions allowing firms to delay implementation until 1 January 2008, but it should be noted that these arrangements do not apply to all aspects of the new regime. For example, the new group risk and definition of capital resources requirements will still be applicable from 1 January 2007.

While the basic minimum capital requirement for most hedge fund managers is likely to remain the same (i.e., one quarter of annual fixed expenditure), the CRD demands closer attention than just focusing on the headlines.

Firstly, regulatory classification of investment businesses under the CRD is more important than was previously the case. Most hedge fund managers will be classified as limited licence firms on the basis that their activities do not generally involve own account dealing or underwriting financial instruments. This means that most hedge fund managers will be subject to the higher of the Fixed Overheads Requirement (FOR, which is similar to the Expenditure-based Requirement under the current rules) and the sum of Market and Credit Risk Requirements (MRR and CRR). Note that MRR and CRR will need to be calculated in all cases!

To calculate the FOR, firms can exclude 'other variable expenditure'. As a consequence hedge fund managers will have more flexibility than previously to decide which of their costs do not form part of the FOR.

Secondly, all hedge fund managers will have to undertake an Internal Capital Adequacy Assessment Process (ICAAP) whereby management considers whether the capital the firm holds is sufficient in relation to the nature and level of the risks it faces. This will require that management take matters such as operational risk, liquidity risk, insurance risk and reputational risk into account within the ICAAP.

Hedge fund managers will continue to be subject to consolidated capital requirements where they form part of a financial group. However, the method of calculating the capital resources requirements of a group may be more onerous under the CRD. In addition, an ICAAP will also have to be undertaken at the group level.

Fortunately for many groups, the existing waiver from consolidated requirements – the so-called 'CAD waiver' – will continue to be available under the CRD. Groups currently benefiting from a CAD waiver should note that, from 1 January 2007, their existing concession will cease to apply and they will need to go through the FSA's formal waiver process. In addition, groups will have to comply with the more onerous eligibility criteria that exists under the CRD. Early submissions of CAD waiver applications are being encouraged by the FSA.

Over the pond

As ever, it remains important for market participants based in Europe to be aware of developments across the Atlantic, and we have seen continued activity from the SEC over the past year.

With effect from February 2006, SEC rules require offshore hedge fund advisers (defined as an adviser whose principal office and place of business is outside the US) to register with the SEC if the offshore adviser has more than 14 clients who are resident in the United States. An offshore adviser must 'look through' each private fund it advises, whether or not those funds are also located offshore, and count each underlying investor that is a US resident as a client for the purposes of determining whether registration is required.

The new rules provide for two significant exemptions:

1. if there is at least a two-year lockup for all new investments made into an offshore adviser's funds, the offshore adviser is not required to register with the SEC under the new 'counting rules'; and
2. an offshore adviser to a private fund whose securities are publicly offered in a country outside the United States can avoid registering with the SEC, provided that the fund is also regulated as a public investment company under the laws of a country other than the US.

An offshore adviser that is required to register with the SEC can avoid most of the substantive compliance provisions of the SEC's rules if it advises only offshore funds. Further details of the exceptions to the requirements available to such offshore advisers under the so-called 'SEC-lite' regime are considered in the US part of the country-by-country section of this report.

Section 3

Current developments in the taxation of hedge funds, hedge fund managers and hedge fund investors

Tax barriers to investment

While there seems to be willingness on the part of the various regulatory bodies to move forward and to establish a regime that allows hedge funds and hedge fund-like products to be marketed more easily on a pan-European basis, taxation still remains firmly in the domain of the governments of the European Member States.

At present there is little evidence of any real willingness, on the part of a number of territories, to accommodate non-domestic product. This has led to a fragmentation of the market with some territories setting up domestic hedge fund regimes with favourable tax treatment for domestic investors, but which have little or no wider appeal because there is no harmonisation of tax treatment within the EU. This in turn has led to fund managers looking for ways to structure around restrictions on distribution.

In this regard, they have been assisted by significant developments in eliminating tax discrimination in relation to investments in UCITS in a number of territories including the UK, France and Germany. This means that it is now realistically possible to market investments in UCITS funds in more than one country. This in turn has led hedge fund managers to look at ways in which hedge fund strategies can be replicated within the framework of a UCITS fund with a view to distribution to a wider investor base and also to the rapid growth in fund-of-hedge funds.

Figure 1 (page 12) highlights the tax barriers to distribution of foreign hedge funds to various investor classes when compared to the tax treatment of domestic hedge funds. We have not identified any significant changes to the position in the last year.

Emerging trends

The last few years have seen a rapid expansion in the investment strategies adopted by hedge funds, presenting new challenges in the area of taxation. In particular, the traditional master/feeder structure is being supplemented by subsidiary funds, often based in EU countries, tailored for the needs of the specific investment strategy. This is particularly the case for funds that employ debt or quasi private equity related strategies.

To date London has been the dominant European location for hedge fund managers because of its historical position as a financial centre and also in part, due to the existence of the UK's investment manager exemption, (which exempts profits of a hedge fund attributable to a UK permanent establishment of that fund from tax and therefore provides some degree of tax certainty). However, this exemption is of less relevance when considering some of the newer strategies. Because certain strategies cannot always benefit from the protection of the investment manager exemption. Examples of this would be funds investing in commodities, trade receivables and some debt strategies. Further, some of these newer strategies, a number of which have features in common with private equity investing, result in significant time being spent by the investment adviser on the ground in negotiating and agreeing transactions. Therefore, there is now a real risk of creating a taxable presence in European countries other than the UK, depending upon where the investments are located. It is therefore becoming more difficult for non-EU domiciled hedge funds to manage investments in EU countries without creating a taxable presence of the fund in that country.

At the same time, jurisdictions such as Hong Kong and Singapore have recently introduced legislation similar to the UK investment manager exemption to encourage the growth of an onshore industry. The US continues to have a tax regime that produces similar results.

While tax authorities are aware of these issues, it is currently unclear how they will react and how such non-EU domiciled funds will ultimately be treated for tax purposes.

In relation to onshore funds, UCITS III provides an EU passport to funds and also allows a wider range of strategies, including some of those more typically employed by hedge funds. However, the differing tax regimes around Europe mean that additional onshore structures or structured products are being used in order for domestic investors to gain access to hedge fund-type returns. It is the penal taxation of offshore funds that requires investors to use these onshore feeder structures or structured products. As long as this situation persists, sophisticated investors, together with fund managers, will continue to find ways in which to structure their investments efficiently. Unfortunately for EU territories, this can result in it being more favourable to continue to base the master fund in an offshore location, such as the Cayman Islands, Bermuda and the BVI, with increasing competition from non EU jurisdictions closer to home such as Jersey and Guernsey.

Taxation of hedge funds

No jurisdiction has established a specific tax regime to cater for domestic hedge funds or hedge fund-like products, relying instead on the existing domestic tax regime. Typically, hedge funds are therefore either:

- taxed at concessionary rates or tax-exempt at the fund level in the same manner as other collective investment schemes, provided certain criteria are satisfied; or
- treated as tax transparent such that tax is levied at the investor level.

Countries such as Malta have developed a fund structure that is exempt from local tax and therefore becoming increasingly attractive as a fund location within the EU. Further, Dubai, with an equally attractive regime, is posing a threat to the more traditional fund locations.

Taxation of investors

Each territory has implemented its own tax treatment of hedge fund returns for each investor class. In some territories, the tax treatment of hedge fund investors is the result of a considered review by the local tax authorities. In many other territories, largely due to the fact that hedge funds are a relatively new investment vehicle for most investor classes, there is no specific tax regime for the treatment of hedge fund returns. Therefore, general local tax principles apply or the return may be taxed in a similar manner to returns from other collective investment schemes, for example, UCITS funds.

VAT

The European Court of Justice (ECJ) has delivered its judgment in the Abbey National case, concerning the VAT exemption for the 'management of special investment funds'. It has followed the Advocate General's opinion in concluding that 'management' is a Community law concept, which is sufficiently broad to cover the provision of fund administration services by outsourcers. However, it has held that the exemption does not extend to the services of depositories and trustees.

The ECJ confirmed the Advocate General's view that 'management' is an independent concept of Community law, which Member States are not at liberty to define, and is exempt where it forms a distinct whole, fulfilling the 'specific, essential functions' of the management of the fund. The ECJ referred expressly to Annex II to the UCITS Directive and the exemption may now include (in appropriate cases) the provision of administrative functions listed in Annex II to the UCITS Directive, such as the issue, marketing and redemption of units, and associated administrative functions such as valuation, book-keeping and compliance. The ECJ disagreed with the Advocate General in holding that the services of depositories and trustees do not fall within the concept of 'management', as they are essentially supervisory in nature.

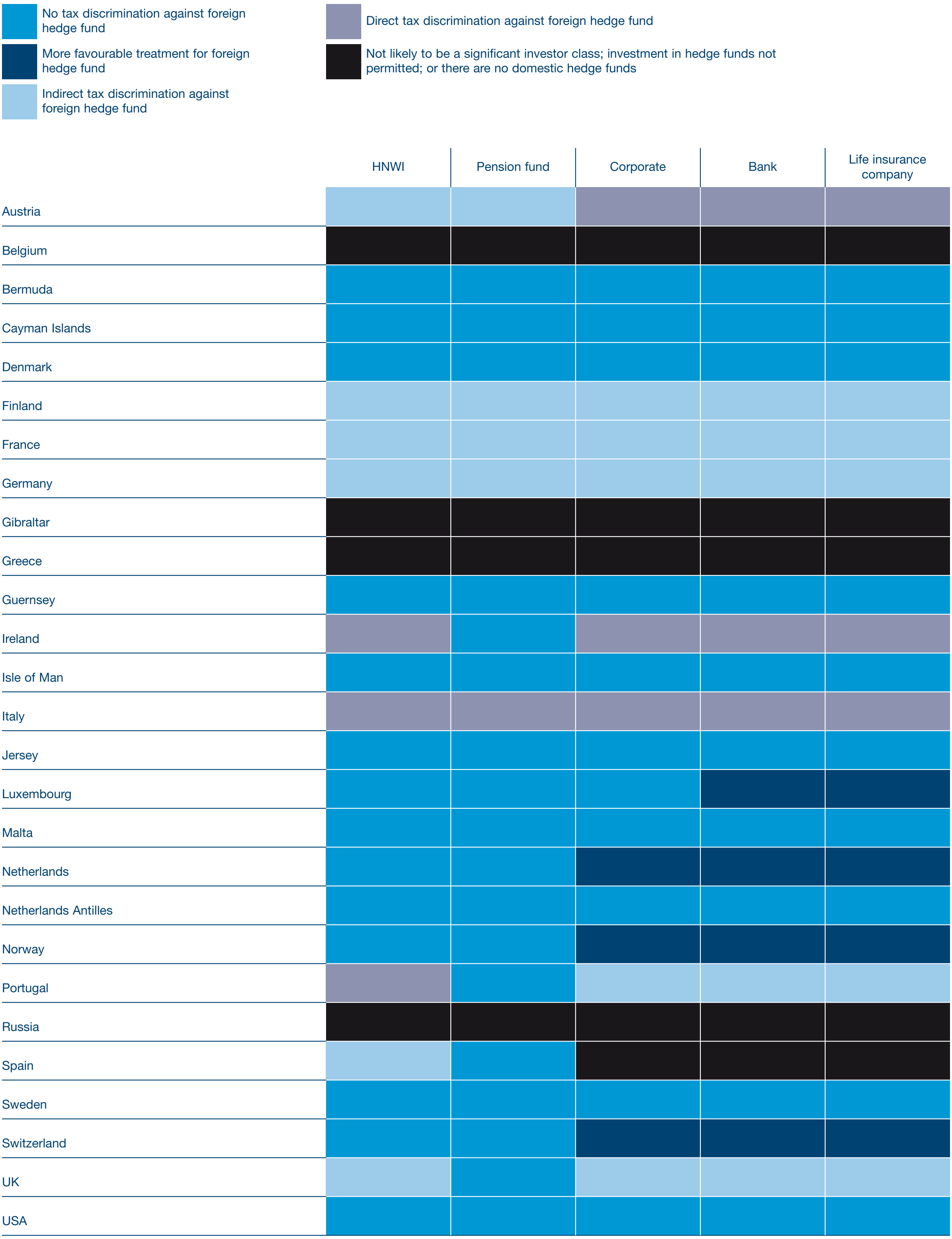
Comments of the ECJ in this case also have implications for another case in the European courts taken by JP Morgan Claverhouse Trust Limited (JPMCTL) and sponsored by the Association of Investment Trust Companies (AITC). JPMCTL asserts that the exemption from VAT for management of assets/funds carried out for authorised unit trusts and open-ended investment companies should also be extended to cover investment trusts and, by implication, potentially to other funds, e.g. hedge funds. The ECJ commented that Member States did have some discretion over which funds are within the scope of the exemption, but also provided some thoughts as to which funds it saw as eligible. Should JPMCTL win its case, it would have an impact on the level of taxable supplies made by investment managers and – consequentially – an impact on their input tax recovery under their partial exemption methods.

Whilst the outcome of the case of JPMCTL and investment trusts is not yet known there is a reasonable argument that other collective investment schemes fall within the exemption following these two important ECJ cases.

Stamp Duty Reserve Tax (SDRT)

With the increasing use of derivatives by hedge fund managers and the taking of large positions over specific companies, there is increasing likelihood that these funds may be taking an interest in shares for SDRT purposes or that tax authorities will want to treat such interests in this way; indeed, recently the Irish tax authorities withdrew an announcement that they were to apply stamp duty to contracts for differences. If these funds effectively have the rights to dividends and capital and to take the voting power associated with the shares, then it would appear as though beneficial entitlement has passed and therefore SDRT may be due when the entitlement transfers.

Figure 1: Tax barriers to the distribution of hedge funds



Section 4

Country-by-country overview:
Regulation and taxation of hedge funds and hedge fund investors at June 2006

AUSTRIA

Regulation

Domestic and foreign fund-of-hedge funds may be distributed to both retail and institutional investors in Austria. Austrian regulation prevents the launch of domestic single-manager hedge funds. Foreign single-manager hedge funds may be distributed to retail and institutional investors, subject to approval from the FMA (Financial Market Authority); however, this approval may not be granted where certain features exist, for example, a fund undertaking uncovered short-selling would not be approved.

Taxation

In December 2004, a new law was passed that eliminated the different tax treatment of income from foreign and domestic funds. Since 1 July 2005, Austrian banks have deducted a final 25% withholding tax on distributions and deemed distributions from foreign funds (calculated by a local tax representative) such that foreign funds are taxed on the same basis as domestic funds, provided that the following requirements are met:

1) The foreign hedge fund appoints a local tax representative to calculate deemed distributed income on an annual basis and provides the Oesterreichische Kontrollbank (OeKB) with this information within four months of the financial year-end (annual reporting).

2) The foreign hedge fund provides the OeKB with information on the net interest income (interest income plus/minus equalisation minus expenses on interest income) on a daily basis (daily reporting).

3) The foreign fund provides the OeKB with information on taxable portions in case of distributions on the distribution date (periodic reporting).

Individual investors are subject to withholding tax on income distributions and deemed income distributions from hedge fund investments at the rate of 25%, i.e. the income from this fund does not need to be included in the personal income-tax return of the investor. Capital gains realised on the disposal of equities are taxed at an effective rate of 5% while capital gains on the disposal of bonds are tax-free.

If individual investors sell the investment fund certificates within one year of acquisition, the gain is subject to progressive income tax as speculative income (up to a maximum rate of 50%).

Corporates, banks and insurance companies are taxed at 25% on both income and capital gains from hedge fund investments. Special rules could apply for insurance companies. However, realised capital gains of domestic funds are only taxable for corporate investors when distributed; the total realised underlying gains of foreign funds are taxable, even if they are not distributed.

Austrian pension funds are exempt from tax in Austria.

The safeguard tax of 1.5% that was deducted by the Austrian depository bank if an Austrian investor held shares in a foreign hedge fund will also not apply if the above conditions are met.

If a foreign hedge fund does not follow this new reporting regime, an Austrian investor of the fund must include the income in his income-tax return. Only distributions paid to Austrian investors holding the shares on Austrian deposit are subject to Austrian withholding tax. The same tax rates as for the reporting funds apply. Safeguard tax will be applicable if the investor does not disclose his/her holdings with the tax office.

If a foreign fund has not appointed a local tax representative, it will be treated as a ‘black fund’ and all investors (except pension funds) will be subject to unfavourable lump-sum taxation whereby the higher of:

(i) 10% of the last redemption price in the calendar year; or

(ii) 90% of the difference between the first and the last redemption price in the calendar year less the actual distribution received by the investor

will be subject to 25% tax.

If foreign funds do not appoint an Austrian tax representative, an Austrian investor is able to provide the tax authorities with information on deemed distributed income to avoid lump-sum taxation (previously such information could only be provided by an Austrian tax representative officially appointed by the fund), although it is very difficult for the individual to collect the information and to calculate these figures.

BELGIUM

Regulation

Access to investments in hedge funds in Belgium is very restricted, as no comprehensive legal framework is currently in force.

Belgium legislation allows for three types of undertaking for collective investments (UCI):

- Public UCIs, targeting retail investors;
- Institutional UCIs, targeting institutional investors as defined by law; and
- Private UCIs, targeting HNWIs investing a minimum of €250,000 through a private placement.

Public UCIs with revenue-guaranteed or revenue-protected characteristics may invest in hedge funds only if certain conditions are met.

It is possible to distribute hedge funds to investors willing to subscribe a minimum of €250,000, by private placement.

Taxation

The tax treatment when investing in a foreign hedge fund depends on whether or not the hedge fund qualifies as a tax transparent entity from a Belgian tax perspective. This in turn has different consequences for different types of investors.

Where the hedge fund is treated as a tax transparent entity from a Belgian tax perspective, all revenues received by the fund will be considered as directly received by its investors.

The taxation of the income will depend on their status and the type of income received. The Belgian tax consequences require case-by-case analysis based on the specific factual circumstances.

In the case of non-transparent hedge funds, Belgian (tax resident) individual investors will be taxed on the dividends distributed by hedge funds and in principle will be subject to a Belgian withholding tax at a rate of 25% or 15%.

In principle capital gains realised upon the sale of shares, redemption by the hedge fund or liquidation of the hedge funds, will not be subject to taxation in the hands of the individual investors. However, some exceptions exist in this respect for capitalisation shares. Belgian individual investors could potentially suffer tax leakage of 15% if:

- there is commitment in the hands of the hedge fund, for a period less than or equal to eight years, regarding the amount to be recovered by the investors; or
- the hedge fund has an EU passport and invests more than 40% in interest-bearing products.

Where no Belgian financial intermediary exists, additional municipality taxes will be levied.

Finally, the Belgian 'Tax on Stock Exchange Transaction' could apply in the case of a sale, redemption or liquidation to the extent that the transaction takes place on the secondary stock market and a Belgian financial intermediary is involved. The application of this tax and its level (if applicable), will depend on the parties involved, the underlying shares and the importance of the transaction.

Corporates (including banks and insurance companies) are in principle taxed at a rate of 33.99% on any dividends or capital gains received in this framework. Under certain conditions, Belgian corporate investors could fall within the participation exemption regime (which provides an exemption from taxation of capital gains realised upon the sale of relevant shares and deduction of 95% of the (deemed) dividends received).

As noted above, direct investment by retail investors in domestic hedge funds is currently not allowed. Accordingly, indirect investment via wrapper instruments is used. The specific tax treatment depends on the type of wrapper.

DENMARK

Regulation

Domestic hedge funds can only be organised in Denmark as 'hedge associations' and are subject to approval by the Danish Financial Supervisory Authority.

Domestic hedge associations are required to appoint a bank as the depository. The bank is required to have its registered office in Denmark or to be a corresponding foreign credit institution with a branch in Denmark with its registered office in another country within the European Union or EEA.

Foreign hedge funds registered outside the EU and the EEA are required to obtain approval as per a domestic hedge association.

Foreign hedge funds registered within the EU or the EEA are required to obtain approval from the Danish Financial Supervisory Authority for distribution in Denmark.

Taxation

Individual investors, corporates, life and general insurance companies investing in hedge funds will be taxed on dividend distributions and unrealised capital gains and losses (individuals up to 59%, others 28%).

Pension funds and life insurance companies are subject to a special pension tax regime and taxed at a rate of 15% on the net yields from investment on a mark-to-market basis. Special rules ensure that life insurance companies are not subject to double taxation.

FINLAND

Regulation

Both domestic and foreign hedge funds may be distributed to 'professional investors' after submission of a notification to the Finnish Financial Supervision Authority (FFSA). In the case of foreign funds marketing to retail investors in Finland, a licence to distribute in Finland must be obtained from the FFSA. Requirements for a foreign hedge fund to be granted a licence include, among others, adequate home state supervision of the fund.

Taxation

Individual investors are taxed annually on their portion of the realised income of a hedge fund structured as a partnership at either 28% or progressive rates. If a hedge fund is structured as a (special) common fund, the investor is taxed at 28% on distributions or redemptions. If a foreign hedge fund is structured as a company (that is similar to a Finnish company) the return is taxed as a dividend generally at progressive rates when received (assuming that the non-Finnish hedge fund is not a tax treaty subject or a company referred to in Article 2 of the Parent Subsidiary Directive).

Corporates, pension funds, banks and insurance companies are taxed annually on their portion of the realised income of a hedge fund structured as a partnership. Where a hedge fund is structured as a (special) common fund, these investors are taxed at 26% on distributions or redemptions. If a non-Finnish hedge fund is structured as a company (that is similar to a Finnish company) the return is taxed as a dividend and is generally fully taxable at 26% when the dividend is received (assuming that the non-Finnish hedge fund is not a tax treaty subject or a company referred to in Article 2 of the Parent Subsidiary Directive).

FRANCE

Regulation

In France, before a fund (whether hedge fund or any other type of fund) can invest in a hedge fund the investment manager must obtain a specific approval from the Autorité des Marchés Financier (AMF), regardless of the amount invested.

In December 2004, the AMF issued new regulations affecting how domestic hedge funds and hedge fund-like products, regulated as either Authorised Funds with Simplified Investment Rules (OPCVM Agreés a Rägles d'Investissement Allégées – ARIA) or Contractual Mutual Funds (OPCVM Contractuels) under the Financial Securities Act of 2004, may be marketed to different categories of investors including retail investors.

There are three types of ARIA fund:

1) 'Simple funds' are subject to certain rules relating to diversification of holdings and may leverage up to 200% of net assets. Investors with a minimum net worth of €1 million or a minimum of one year of relevant work experience are subject to a minimum investment threshold of €10,000. Other individual investors are required to make a minimum investment of €125,000.

2) 'Leveraged funds' are subject to identical rules regarding diversification and minimum investment thresholds as Simple funds, but may leverage up to 400% of net assets.

3) 'Fund-of-alternative funds' may leverage up to 200% of net assets and are required to invest in a minimum of 16 underlying funds. Where investors are provided with a guarantee of capital preservation, there is no minimum investment threshold; otherwise, there is a threshold of €10,000.

Contractual Mutual Funds are not subject to rules relating to diversification of holdings or a limit on the amount of leverage they may employ. Investors with a minimum net worth of €1 million or a minimum of one year of relevant work experience are subject to a minimum investment threshold of €30,000. Other individual investors are required to make a minimum investment of €250,000.

To operate Contractual Mutual Funds, investment managers must obtain a specific approval from the AMF. There is no specific approval required for an ARIA fund.

Taxation

The new French legislation referred to above mainly deals with regulatory matters. Currently, the taxation rules are applied, based on the existing OPCVM taxation principles (French UCITS), which provide for tax exemption at the level of the fund (tax transparency). New tax provisions are likely to be implemented in the next couple of years to specifically address the taxation of hedge funds.

Individuals are taxed on receipt of income at marginal income-tax rates (up to 40% + 11% of social contributions); or on capital gains at 27% (including social contributions).

Corporations, banks and insurance companies are taxed on receipt of dividends and taxed annually on the adjusted liquidation value of the shares (on a mark-to-market basis). Generally, pension funds may benefit from total tax exemption on capital gains and suffer a maximum 24% taxation on other income.

French investors in foreign funds are normally taxed on the same basis, provided the foreign fund is considered resident in the foreign country and under double-tax treaty provisions signed by France. In other cases, depending on the French tax analysis of the foreign fund's status, the tax transparency of the fund may not be recognised and all income distributed from the foreign-based fund may be taxed at maximum individual and corporate tax rates. This tax issue is very important for hedge funds domiciled in jurisdictions such as the Bahamas or the Cayman Islands, which are considered as tax havens for French tax purposes. This may consequently trigger some adverse French (Controlled Foreign Company 'CFC') issues.

GERMANY

Regulation

The Investment Act of 2004 introduced a new regime covering both single manager hedge funds and fund of hedge funds. Single manager funds, both domestic and foreign, may not be distributed to retail investors in Germany. Foreign fund-of-hedge funds may be publicly distributed in Germany once registered with the regulator, the Bundesanstalt fÅr Finanzdienstleistungsaufsicht (BaFin). Registration will only be granted in cases where BaFin considers that home state regulation of the fund is effective and that the home state regulator is prepared to cooperate satisfactorily with BaFin.

The Investment Act of 2004 and subsequent decrees allow for the cross-border appointment of prime brokers and fund administrators within the EU for domestic single-manager funds. Additionally, German regulations allow asset management functions to be delegated to an investment manager established outside Germany, whether within the EU or in non-EU countries, provided the investment manager is subject to effective home state supervision.

In April 2005, the German Federal Ministry of Finance circulated a consultation paper aimed at amending the Investment Act of 2004. Envisaged amendments include, inter alia, a new set of rules for prime brokers of German single-manager hedge funds. The lawmakers are also considering the introduction of a legal definition of the term ‘prime broker’, as well as the clarification of legal relationships between the prime broker, the depository and the management company. The new framework is expected to include a list of the permitted activities of prime brokers and specific safeguards relating to custody services, rehypothecation and collateralisation to guard against any claims by prime brokers against funds’ assets.

Based on the Ordinance on the Investments of Restricted Assets of Insurance Undertakings (Anlageverordnung-AnlV), issued by the German insurance regulator, insurance companies may invest up to 5% of committed assets in domestic hedge funds and fund-of-hedge funds and EEA-domiciled hedge funds and fund-of-hedge funds that are subject to supervision in their home country. Additionally, insurance companies may invest in hedge funds indirectly via regulated mixed funds, which can invest up to 10% of their net asset value in domestic and foreign single-manager hedge funds. Indirect investments in hedge funds are also possible via wrapper products issued by EEA-domiciled hedge funds and fund of hedge funds. Total direct exposure to a single hedge fund may not exceed 1% of the committed assets and overall total exposure (direct and indirect) may not exceed 5% of committed assets.

Taxation

A new tax law governing the taxation of fund investors came into effect at the end of 2003. It classifies the funds as either transparent or non-transparent, depending on the fund’s level of German tax reporting. The new tax rules provide a level playing field for German and non-German hedge funds and abolish the prior discrimination against foreign funds.

The most important tax reporting obligation for German and foreign funds is that a tax transparent fund has to determine its income/capital gains under German tax law.

Funds will only be treated as tax transparent if:

- the fund calculates taxable income in accordance with German law;
- the fund calculates and publishes distributed and accumulated income;
- the fund obtains a tax certificate; and
- the fund files tax returns with the German authorities upon request.

A tax adviser, an auditor or comparable professional has to certify that the fund’s German tax reporting is in line with German tax law. Incorrect reporting may trigger liability.

In June 2005, the German tax authorities published the final version of a decree (over 100 pages) on the taxation of investment funds and the required compliance with reporting requirements, which determine whether a fund (domestic or foreign), can be treated as tax transparent.

Dividends, interest and other income (less expenses) generated by an accumulating fund will accrue to the German investor as a deemed distribution at the business year-end of the transparent fund. Capital gains generated by an accumulating fund do not accrue to the investor as part of the deemed distribution (tax deferral effect for institutional investors).

Individual investors are taxed on distributed/accumulated income generated by the hedge fund at marginal income-tax rates between 15% and 42%. Income from dividends generated by the fund is 50% tax-free. Capital gains from the sale/redemption of hedge fund investments by individual investors are tax-free after a one-year holding period.

Corporates and banks are taxed at 25% on distributed/accumulated income generated by the hedge fund. The same tax rate applies to capital gains from the sale/redemption of hedge fund investments. However, there is an exception: dividends and capital gains from long equity investments generated by the fund are 95% tax-free at the corporate investor level, whether distributed by the fund or realised

GERMANY Continued

by the investor upon sale/redemption of the investment in the hedge fund.

Pension funds and insurance companies are taxed at 25% on distributed/accumulated income generated by the hedge fund. Capital gains from the sale/redemption of hedge fund investments are fully taxable.

Investors who hold non-transparent funds at the end of the calendar year are subject to punitive lump-sum taxation, irrespective of the fund's actual income or capital gains.

The investor in an accumulating non-transparent fund is taxed on 70% of the positive increase between the first and the last NAV of the fund in the calendar year. At least 6% of the last NAV of the fund in the calendar year is taxable, even if the fund NAV decreased during the calendar year. The tax rates are the same as mentioned above.

It is noteworthy that the taxation rules for private and business investors of the transparent fund are usually more tax beneficial than a direct investment into the assets held by the fund. These significant tax benefits correlate with enhanced but manageable reporting requirements.

GIBRALTAR

Regulation

For a number of years, Gibraltar has experienced growth in its hedge fund industry. Due to the number of new entrants into the market and the interest generated in establishing funds in Gibraltar, the government of Gibraltar issued the Financial Services (Experienced Investor Fund) Regulations 2005. This has enhanced the existing regulatory structure that existed under the Financial Services Ordinance 1989 and Financial Services (Collective Investment Scheme) Regulations 1991 and increased the choice available to hedge fund promoters, allowing for greater flexibility, lower set-up costs and a general streamlining of the set-up process.

Effectively, corporates, trusts and individuals alike can now choose to invest or set up two different types of fund entity:

- Public fund (PF): A PF can actively market to investors and is regulated by the Financial Services Commission in Gibraltar. A PF must have a minimum share capital of ú50,000 and a minimum of 50 shareholders. The average time for licensing a PF is approximately two months. Other conditions for establishing a PF are that a prospectus must be issued, that there are two Gibraltan resident directors and that the fund has a registered office in Gibraltar. A PF may license itself as a UCITS fund. Such funds are then able to passport their services within the EU on the basis of their Gibraltar licence.
- Experienced Investor Fund (EIF): EIFs are only open to a select group of 'qualifying investors' and cannot be actively marketed. There are various criteria to be met in order to be classified as a qualifying investor.
- Both PFs and EIFs must be managed and controlled by an administration company regulated by the Financial Services Commission in Gibraltar and any investments must be held by a licensed custodian or prime broker. Experienced investor funds are also required to produce audited annual accounts.

Taxation

In Gibraltar there is no capital gains tax. The Commissioner of Income Tax in Gibraltar has ruled that the investment income of any fund approved by him as a certified PF or EIF will be exempt from tax.

GREECE

Regulation

Greek legislation effectively prevents the establishment of domestic hedge funds, unless under a UCITS III form (which seems unlikely under current practice). Distribution of foreign hedge funds by private placement is permissible, subject to the granting of a licence by the Capital Markets Committee.

Taxation

Individuals are taxed, based on a tax scale ranging from 15% (for income exceeding €9,500) to 40% (for income exceeding €23,000). Individual investors are not taxed on income and capital gains from UCITS funds. For non-UCITS funds, in the absence of any special provision, the taxation will depend on the legal form of the fund (but generally it is expected that the respective income would be fully taxable at the rates above).

Corporates, banks and insurance companies are taxed on income and capital gains from UCITS funds at 29% (reducing to 25% in 2007) when the respective income and gains are distributed. Special rules determine how taxation may be deferred by allocating the profit that is not distributed to a special tax reserve. Pension funds are exempt from tax, although special rules may apply, depending on the type of pension fund.

GUERNSEY

Regulation

There are very few restrictions in Guernsey in respect of distributing hedge funds to local investors.

Qualified Investor Funds (QIFs) are subject to a 'light touch' regulatory regime. QIFs, which are available only to professional investors, have existed for some time now and the QIF regime has recently been made even less onerous: regulated administrators can now 'self-certify' funds, allowing regulatory approval to be achieved in three days. As the regulatory burden falls on administrators, there is an onus on them to ensure that appropriate due diligence has been performed.

Taxation

Individual investors investing into hedge funds are taxed, on a receipts basis, at the rate of 20% on income. Capital gains are exempt.

Banks, insurance companies (non-life business) and corporate entities are taxed on income from hedge fund investments at the rate of 20% on a receipts basis. Pension funds are not taxed. Capital gains are exempt.

Changes were recently proposed to the local tax regime. The proposals do not include any changes to the tax treatment of hedge funds. It is also proposed to tax hedge fund managers at 0% in the future.

IRELAND

Regulation

The Irish Financial Regulator continues to streamline the hedge fund approval process: hedge funds no longer have to formally obtain the pre-approval of prime brokerage documentation, provided that the fund's legal advisers certify compliance with requirements for such documentation. This reduces the length of the approval process.

QIFs may enter into over the counter (OTC) contracts, provided that they hold all their assets with a prime broker rather than a custodian.

Professional Investor Funds (PIFs) are able to place their assets with a prime broker up to a limit of 140% of the fund's borrowings from the prime broker. Any balance of assets held with the same prime broker will be required to be segregated from the prime broker's own assets in a separate custody account and subject to a separate custodian agreement. PIFs may enter into OTC contracts provided that exposure to each individual counterparty does not exceed 20% of NAV (30% in the case of certain credit institutions).

The Investment Funds, Companies and Miscellaneous Provisions Act took effect on 30 June 2005 and provides a framework for institutional investors to pool their assets in domestic non-UCITS funds known as Common Contractual Funds. This Act also introduced protected cell legislation for umbrella investment companies and allows for cross-investment between sub-funds of investment companies.

For Irish-domiciled fund of hedge funds, there are no minimum subscription requirements for retail investors.

Irish company law has been amended to allow investment companies to produce their accounts using US GAAP, Canadian GAAP, or Japanese GAAP, in addition to UK/Irish GAAP or International Financial Reporting Standards (IFRS).

Taxation

Irish resident individual investors in hedge funds are generally subject to tax on income at the standard rate of income tax (currently 20%) and on capital gains at the standard rate of income tax plus 3% (23%) on a receipts basis. For investors who acquired their interest in the fund on or after 1 January 2001, the holding of shares at the end of a period of 8 years from acquisition (and thereafter on each 8 year anniversary) will constitute a deemed disposal and reacquisition at market value by the Shareholder on the relevant Shares. The tax payable on the deemed disposal is subject to tax at the standard rate of income tax plus 3% (currently 23%). Any tax arising on such a deemed disposal will be taken into account in respect of any subsequent disposal of the relevant Shares.

If the hedge fund is located in a country outside the EU and with no double tax agreement with Ireland ("non-EU/non-DTA country"), individual investors will be taxed at 42% (plus 5% social insurance/health levy) on income and gains on a receipts basis (gains on disposal of units in a fund which has been designated by the Irish Revenue as a "distributing fund" are liable to capital gains tax at 40% and are not liable to social insurance/health levy).

Corporate investors in hedge funds are subject to tax on trading income at 12.5%, non-trading income at 25% and capital gains at either 12.5% or 23% (normally on a receipts basis). If the hedge fund is located in a non-EU/non-DTA country, corporate investors will be taxed on capital gains at 40% (qualifying distributing funds) or 25% (non-distributing funds) on a receipts basis.

In general, bank and insurance company investors in hedge funds are subject to tax on income and capital gains at 12.5% on a mark-to-market basis, although realisation basis applies in certain circumstances. Where such companies are reporting under IFRS, the accounting profit (fair value) will form the basis of the taxable profits. Pension fund investors are tax exempt.

Legislation introduced in the 2004 Finance Act effectively ensures that locating the investment management activity of a hedge fund in Ireland does not give rise to an Irish tax exposure for the fund once it meets certain independence criteria.

ISLE OF MAN

Regulation

There have been no recent changes to the regulatory environment in the Isle of Man.

Administration of PIFs must be carried out in the Isle of Man. However, PIFs are not subject to any further Manx regulation. The EIF is a further special subcategory of the Isle of Man's international collective investment schemes classification. The EIF is specifically developed as a vehicle for global investors with a high degree of experience and is designed to be both simple and flexible to administer. The fund itself is not subject to regulatory approval, and the onus for its proper administration is laid firmly on the licensed fund manager or fund administrator. EIFs can be limited companies, limited partnerships or 'cell companies'.

Foreign funds may be administered in the Isle of Man without being subject to Manx regulation.

Taxation

With effect from 6 April 2006 all companies (excluding licensed banks and companies that receive income from land and property situated in the Isle of Man) will be taxed at 0%. This complements the favourable tax position of fund managers who were previously taxed at 0% on their fund management activities.

ITALY

Regulation

Domestic and foreign hedge funds are required to be authorised by the Bank of Italy and CONSOB (Commissione Nazionale per le Societa e la Borsa).

The CONSOB regulates the distribution of foreign and domestic hedge funds. Distribution to individual investors is restricted by the fact that no public marketing is allowed, a €500,000 minimum investment requirement and a maximum limit of 200 shareholders.

Domestic hedge funds are required to appoint an Italian bank or an Italian branch of a bank incorporated in another EU Member State as a depository bank.

Taxation

Individual investors in domestic hedge funds are not subject to tax on income from capital. Taxation applies at the level of the domestic hedge fund. In particular, a substitute tax at a rate of 12.5% applies on the annual management result of the fund. For individuals investing in foreign hedge funds, income is subject to ordinary tax at progressive rates by brackets of income covering 23-43%.

Corporates, banks and insurance companies investing in domestic hedge funds are subject to corporation tax of 33% (with a tax credit of 15% on income from capital 3). Corporates, banks and insurance companies receiving income from foreign funds are subject to tax at 33%.

Banks and insurance companies may also be subject to regional tax under certain circumstances on hedge fund income.

Pension funds that invest in domestic hedge funds are subject to taxation at a rate of 11% with a tax credit of 15% of income from capital received. Pension funds that invest in foreign hedge funds are subject to tax at 12.5%.

Notes:

1. Income from capital broadly corresponds to the increase in the net asset value of the fund accrued during the period of ownership of the units. Proceeds arising from the disposal, the redemption or the distribution of income in the hands of individual investors (that hold the units other than in connection with a business activity) qualify as income from capital. Any income received in excess of capital qualifies as miscellaneous income and is subject to substitute tax at a rate of 12.5%.
2. A withholding tax at a rate of 12.5% may be levied by Italian authorised intermediaries upon collection as advance payment of total tax due from individuals, corporates, banks, insurance companies and pension funds.
3. The tax credit relates to the 12.5% substitute tax suffered at the fund level.

JERSEY

Regulation

The Jersey Financial Services Commission (JFSC) has a long-term plan to consolidate and streamline the regulatory framework into a single statute focusing on the regulation of service providers rather than the underlying products and structures they administer. As part of this plan, a Code of Practice for fund functionaries will be published within the next 18 months. In the intervening period, the JFSC is expected to release a high level 'Statement of Principles' regarding the conduct of business.

Since February 2006, companies may be established as a 'Protected Cell Company' (PCC) or an 'Incorporated Cell Company' (ICC). Jersey is the first jurisdiction to introduce the ICC concept, which permits the formation of separate cells with each cell established having its own separate legal personality.

Taxation

Individual investors investing into hedge funds are taxed, on a receipts basis, at the rate of 20% on income. Capital gains are tax-exempt.

Banks, insurance companies (non-life business) and corporate entities are taxed on income from hedge fund investments at the rate of 20% on a receipts basis. Pension funds are not taxed. Capital gains are tax-exempt.

Changes were recently proposed to the local tax regime. The proposals do not include any changes to the tax treatment of hedge funds. It is also proposed to tax hedge fund managers at 0% in the future.

LIECHTENSTEIN

Regulation

There have been no recent regulatory changes concerning hedge funds and fund of hedge funds. Under current law domestic IUG (Law on Investment Undertakings) regulated hedge funds and fund-of-hedge funds need a local custodian bank and a local administrator. Foreign sub-custodians are acceptable and certain administrator services can be further delegated by the administrator to foreign administrators. Liechtenstein currently does not know a typical prime broker concept.

For domestic IUG regulated hedge funds and fund-of-hedge funds the formal 'fund management company' as defined by the law has to be domestic. However, portfolio management services can be delegated to a foreign investment adviser.

Foreign hedge funds and fund-of-hedge funds approved for distribution in Liechtenstein need a domestic approved representative and a domestic paying agent for the settlement of subscriptions, redemptions, distributions, etc.

IUG regulated open-ended Liechtenstein hedge funds or fund-of-hedge funds and foreign regulated hedge funds approved for distribution in Liechtenstein can be sold to retail, high-net-worth and institutional investors. Alternatively, a bank or other professional asset manager can distribute hedge funds and fund-of-hedge funds within the scope of an approved and disclosed formal asset allocation policy, based on a discretionary management contract with the client. The distributor of IUG regulated funds generally either is an FMA (Finanzmarktaufsicht Liechtenstein) regulated institution or has to obtain the FMA's approval as a distributor.

Furthermore, hedge funds and fund-of-hedge funds not approved for distribution in Liechtenstein still can be used within the scope of the asset allocation policy applied on discretionary management contracts, or can be sold to investors on their own request, but such funds must not be publicly advertised and promoted.

Taxation

Hedge funds currently incur a capital tax of 0.1% on the first CHF2 million of the fund's capital and 0.04% on the capital exceeding CHF2 million.

New tax legislation is planned to become effective from 1 July 2006. According to the planned new tax legislation, the capital taxation will be withdrawn so that there will be no taxation on the fund's capital from 1 July 2006 onwards.

There is no withholding tax levied in Liechtenstein on distributions of the fund. The investors receive the whole distribution without any deductions, independent of where the investors (corporations or individuals) have their tax residence.

Individual investors that are tax-resident in Liechtenstein have to declare the income received from hedge funds on their normal income-tax return. In Liechtenstein, individuals are taxed, based on realised capital gains while unearned income is not taxed.

Tax privileged Liechtenstein companies, like privileged foundations, do not pay any income tax at all. Any capital gain or distribution from a hedge fund is therefore tax-free.

LUXEMBOURG

Regulation

Luxembourg retail investors can invest in hedge funds and fund-of-hedge funds domiciled in any country, provided that the fund is approved by the Commission de Surveillance du Secteur Financier (CSSF) for public offering. Only funds that are subject to home state supervision which the CSSF deems to be adequate will be approved.

The implementation in May 2005 of the CSSF's circular on the use of derivatives in UCITS III funds (Circular CSSF 05/176) is expected to encourage the development of hedge fund-like products. This circular allows the creation of UCITS with significant leverage as exposure to derivatives can be calculated on a Value-at-Risk (VaR) basis.

Authorised hedge fund managers operating in Luxembourg are not required to obtain authorisation for each new fund that they launch, other than approval by the CSSF for domestic funds.

A new law is expected to introduce QIFs. The draft law imposes no investment restrictions and will allow small entities to create domestic funds. QIFs will be subject to a minimum investment of €125,000 per investor.

Taxation

Luxembourg resident individual investors are taxed on receipt of income deriving from hedge fund investments at their progressive tax rates up to a maximum of 38.95%. Capital gains realised by a Luxembourg resident individual investor are exempt after six months if his/her shareholding in the fund does not exceed 10% and the disposal takes place more than six months from the date of acquisition. Otherwise, if the disposal takes place within six months of the acquisition the capital gains will be taxed at 38.95% (some allowances are available). If the disposal takes place after six months and the shareholding exceeds 10%, the capital gain will be taxed at half the rate mentioned.

In certain situations, depending on the characteristics of the fund and location of the paying agent, the European Union Savings Directive (EUSD) may be applicable resulting in either exchange of information or withholding tax being levied.

Banks, insurance companies and corporate entities are taxed upon receipt of income and capital gains from hedge fund investments at the rate of 29.63%.

For pension fund investors, income and capital gains from hedge fund investments are included in their taxable base; however, pension schemes generally are tax neutral.

MALTA

Regulation

The Maltese Investment Services Act provides a comprehensive regulatory regime for investment services and collective investment schemes (CIS) – which include PIFs. All hedge funds that have been set up in Malta are PIFs.

The Malta Financial Services Authority (MFSA) is responsible for the licensing, regulation and supervision of CISs, including PIFs. The main regulations concerning the establishment and regulation of hedge funds in Malta are:

- Hedge funds may not be marketed to retail investors in Malta although Malta's entry into the EU means that UCITS funds (which may have certain hedge fund-like characteristics) are eligible for a 'passport' enabling them to be marketed in Malta.
- Hedge funds are typically established as PIFs; however, it is also possible for a fund established overseas to transfer its domicile to Malta and apply to be registered as a PIF.
- PIFs may be marketed to corporates and trusts, as well as the following types of individual investor:
  - Qualifying Investors: there are various criteria to be met to be classified as a qualifying investor. However, the main criteria is that the investor must have more than USD1 million of net assets and that the minimum initial investment is at least USD100,000 (or equivalent in another currency).
  - Experienced Investors: these are defined as persons having the expertise, experience and knowledge in the acquisition/disposal of funds of a similar risk profile to which the proposed PIF relates. The minimum investment threshold is USD20,000.
- There are no restrictions on the investment powers of a PIF. However, there is a restriction on the extent of leverage through the use of derivatives or borrowing in the case of PIFs marketed to Experienced Investors.
- The MFSA has committed to process applications for the authorisation of PIFs within seven working days, provided all relevant documentation has been provided and that all functionaries are based and regulated in a 'Recognised Country' (i.e. members of the EU or EEA and some other specified countries).

Taxation

As to the tax treatment of investors in hedge funds, any distributions to non-resident investors and capital gains made by such investors on exit are exempt from Maltese tax. However, a 15% final tax is imposed on distributions to Maltese-resident non-corporate investors and capital gains made on exit by Maltese residents.

NETHERLANDS

Regulation

Foreign hedge funds can be authorised for distribution in the Netherlands, subject to the same rules as ordinary investment funds: these rules require the manager to obtain a licence prior to distributing beyond a group of professional investors, unless an exemption is available.

The Netherlands Authority for the Financial Markets (AFM) will grant such a licence provided certain requirements are met. These include consideration of whether the manager is subject to adequate supervision in another jurisdiction. The AFM has determined that currently only a limited number of countries provide appropriate levels of supervision.

An amended version of the Act on the Supervision of Investment Institutions (Wet toezicht beleggingsinstellingen WTB) became effective in September 2005. The amended Act implemented UCITS III into Dutch legislation and introduced new requirements relating to the organisation and transparency of hedge fund managers.

The main effects on hedge funds and their managers are as follows:

1) Domestic hedge fund managers are required to obtain a licence from the AFM and may then launch new sub-funds in existing hedge funds without the individual sub-funds being required to obtain a separate licence, provided an updated prospectus is available.

2) Foreign hedge fund managers established in countries that the AFM has determined apply appropriate home country supervision may apply

for a licence. Hedge fund managers in other countries may apply for a licence as well. However, the AFM has the ability to impose additional requirements on such managers.

The Act on Financial Services (Wet financiele dienstverlening WFD) took effect on 1 January 2006. The Act requires providers of various types of financial services (offering and acting as intermediary in relation to financial products) to obtain a licence from the AFM. Hedge fund managers will not be required to obtain a second licence in addition to the one required by the amended WTB. Legal entities and natural persons making offers of shares in hedge funds or providing advice to the public on hedge funds will be required to obtain a licence under the WFD.

Taxation

Individual investors are deemed to receive a notional yield of 4% on hedge fund investments, which is taxed at the rate of 30%. Distributions of actual income and gains are not taxable.

Banks, insurance companies and corporate entities are taxed on income and capital gains from hedge fund investments at the corporate tax rate of 29.6% (2006 rate). Pension funds are exempt from corporate income tax.

A participation exemption is available in respect of investments in EU hedge funds and fund-of-hedge funds that exceed a shareholding of 20%, provided certain conditions are met.

Capital duty was abolished from 1 January 2006.

NORWAY

Regulation

Under current regulations, the Norwegian Securities Fund Act prohibits the solicitation of subscriptions in hedge funds, from both individuals and legal entities, although foreign hedge funds may be actively promoted in Norway with the permission of the Norwegian Financial Supervision Authority (FSA). However, we are not aware of any foreign hedge fund that has as yet been granted permission by the FSA to be promoted in Norway.

The Ministry of Finance issued a consultation paper proposing to allow hedge funds to be marketed to professional investors. The consultation period ended in April 2005, but the Ministry has not yet announced whether the Securities Fund Act will be changed in order to allow solicitation of subscriptions in hedge funds to professional investors.

Taxation

Individual investors, tax-resident in Norway, will be subject to tax at 28% on income and capital gains on a receipts basis from hedge fund investments structured as corporate vehicles. From 1 January 2006 a component of the return (currently estimated at 2.1% of cost price) will be tax-exempt.

Hedge funds structured as partnerships will be treated as tax transparent in Norway and all classes of investors will be taxed on a proportionate part of the hedge funds income under the tax regulations applicable for each investor.

Corporate investors in EEA-domiciled hedge funds, structured as corporate vehicles, will be exempt from tax on dividends received and gains on shares under participation exemption rules, regardless of the level of holding or the time period for which the shares have been held. Losses will not be tax-deductible.

For corporate hedge funds domiciled outside the EEA, the participation exemption for capital gains will only apply where the shareholder holds 10% or more of the capital and voting rights of the fund for a period of two consecutive years. In addition, the Participation Exemption will not be available where the hedge fund is situated in a low tax country.

PORTUGAL

Regulation

Short selling, leveraging, investment concentration and use of derivatives are permitted in Special Investment Funds (SIFs), but are subject to limits. Fewer rules apply than with mutual funds, but certain rules are still applicable to SIFs, for example those relating to authorisation by the Portuguese Stock Market Commission (CMVM) and transparency.

Portuguese hedge fund managers seeking to launch funds that do not qualify as a SIF (for example foreign funds) need to request authorisation from the CMVM in order to manage such funds.

Taxation

Individual investors into domestic hedge funds are exempt from tax, unless the income is connected with commercial, industrial, or agricultural activity, which is taxed at marginal rates, but withholding tax up to 25% is imposed at the fund level. Capital gains are taxed at 10%, unless gains are connected with commercial, industrial, or agricultural activity, which are treated as taxable profits taxed at normal rates.

Individual investors in foreign hedge funds are subject to tax at marginal rates up to 40%, although distributions by paying agents located in Portugal are taxed at 20%. Capital gains are taxed at a flat rate of 10%.

Corporations, banks and insurance company investors in domestic hedge funds are taxed on income and capital gains (up to 27.5%). These entities can recover the tax paid at the fund level. Pension funds are exempt from tax and may reclaim withholding tax and any tax paid by the fund. Income derived from a foreign fund is treated as taxable profit.

Foreign investors in domestic hedge funds are exempt from tax on income and capital gains. The exemption on capital gains does not apply in cases of investors resident in offshore countries, or corporate investors held by Portuguese entities with a participation of at least 25%.

RUSSIA

Regulation

Generally, asset management activity is regulated by the Federal Service of Financial Markets (FSFM) and is subject to licensing. There are currently no regulations specific to hedge fund products in Russia and, depending on the exact circumstances, domestic hedge fund products may or may not be subject to regulation by the FSFM. Foreign hedge funds can only be promoted in Russia if there is an agreement with the country of domicile and/or the regulatory authority of that country. However, we are not aware of any cases where such agreement has been reached.

Taxation

Individual investors in a domestic unit investment fund (UIF) are taxed at a rate of 13% on distributed income and capital gains. Corporate entities, banks and insurance companies are taxed at a rate of 24% on income distributable by UIF and capital gains. Pension funds are taxed at a rate of 24% on income and capital gains. Generally, the profits tax base of non-state pension funds is determined as the difference between return on investments and return under the refinancing rate of the Central Bank of Russia (currently 12% on Russian rubles).

For foreign hedge funds, individuals are taxed on dividend income at a rate of 9% (13% on other income). For corporate entities, banks and insurance companies, dividend income is taxed at 15% (subject to double-tax treaty relief) and other income at 24%. Pension funds are taxed at 24%. Capital gains are taxed at 24%.

SPAIN

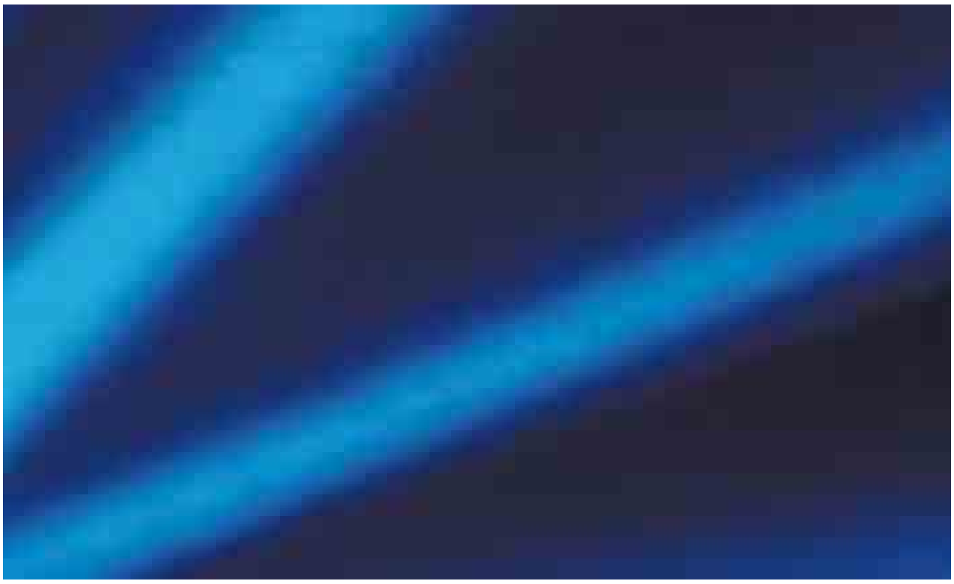
Regulation

Implementation of the new regulatory framework for hedge fund products and hedge fund managers has been almost fully completed with the adoption of Circular 1/2006, dated 3 May 2006, relating to Free Investment Collective Undertakings (i.e. domestic single manager hedge funds and fund of hedge funds). The new regulations will enter into force following publication in the Spanish Official Gazette and will supplement the general regime of Law 35/2003 on undertakings for collective investments (which was adopted in November 2005 and provided a basic framework for launching and distributing domestic single-manager hedge funds and fund-of-hedge funds in Spain) and Royal Decree 1309/2005 dated 4 November 2005.

The framework covers, inter alia, the distribution of domestic hedge fund products to institutional and retail investors, and specific requirements for hedge fund managers regarding authorisation and ongoing requirements covering organisational matters, internal control and risk management matters, as well as controls over outsourcing and operational risk.

Distribution of single manager hedge funds is limited to qualified investors. Retail investors will be allowed to subscribe for units in fund-of-hedge funds under certain conditions, including a requirement to comply with diversification rules and to ensure that the underlying hedge funds meet specified eligibility requirements.

Marketing of foreign hedge fund products remains subject to prior authorisation by the Comisi¢n Nacional del Mercado de Valores (CNMV). However, it seems likely that authorisation could be granted in cases where foreign hedge fund products are subject to similar regulatory requirements as those now applicable to domestic funds. The CNMV is likely to pay particular attention to investor protection matters in determining whether authorisation will be granted.



Taxation

Individual investors in Spanish hedge funds or fund-of-hedge funds would be taxed similarly as if they invested in Spanish UCITS funds. Distributions would be taxed as ordinary income at full progressive rates (ranging from 15% to 45% in 2006), while the redemption or sale of participations or shares in the fund would be taxed as capital gains at progressive rates (15% to 45%), if the holding period does not exceed one year or at a fixed 15% rate if the holding period exceeds one year.

Individual investors in foreign hedge funds or fund-of-hedge funds are not taxed under rules similar to those applicable to investors in Spanish funds. This is due mainly to the fact that such funds are not included in the scope of application of the UCITS Directive. The taxation may vary significantly, depending on the legal status of the vehicle and on whether the fund is resident or not in a black-listed tax haven jurisdiction.

Corporates, banks and insurance companies are taxed at 35% on both income and capital gains. Investment funds and SICAVs are taxed at a 1% rate and pension funds are not subject to tax. Investments in Spanish hedge funds or fund-of-hedge funds are taxed (except in the case of pension funds) similarly as if they invested in Spanish UCITS funds and rules for the computation of income or gains would vary depending on the specific accounting guidelines applicable to ordinary corporations or to each type of institutional investor and on the choices the institutional investors may make for accounting purposes.

Corporate investors in foreign hedge funds or fund-of-hedge funds are not taxed under rules similar to those applicable to investors in Spanish funds. As in the case with individual investors, this is due mainly to the fact that such funds are not included in the scope of application of the UCITS Directive.

There are different tax rules for the taxation of investment in foreign hedge funds or fund-of-hedge funds depending on:

- the legal status of the fund;
- its fiscal residence;
- the specific accounting guidelines applicable to ordinary corporations or to each type of institutional investor;
- choices the institutional investors may make for accounting purposes; and
- regulatory approvals for marketing in Spain.

Tax reform has been announced in Spain for 2007, which will entail a significant change in the taxation rules applicable to individual investors as well as a reduction of corporate tax rates.

SWEDEN

Regulation

Approval from the Swedish Financial Supervisory Authority (FSA) is required, prior to distributing or marketing foreign hedge funds in Sweden. Registration takes approximately two months and is only granted if certain requirements are met, including that the foreign hedge fund is subject to adequate home state supervision.

Domestic funds are required to obtain a licence from the FSA following the same procedures as for UCITS III funds, but applying for exemptions regarding specific investment restrictions.

Swedish fund-of-hedge funds are permitted to invest in foreign hedge funds and may be marketed to retail investors.

Single-manager hedge funds may be distributed to retail investors.

Taxation

Individual investors are taxed, on a receipts basis, on income and capital gains from hedge fund investments at the rate of 30%.

Banks and insurance companies (non-life business) are taxed on income and capital gains from hedge fund investments at the rate of 28% on an accruals basis (although they may elect for a receipts basis).

Other corporate entities are taxed on income and capital gains from hedge fund investments at the rate of 28% on a receipts basis.

SWITZERLAND

Regulation

The new federal Collective Investment Schemes Act (CISA), affecting the Swiss fund market (including hedge funds and hedge fund managers), will replace the current Investment Funds Act (IFA). The proposed new Act is currently in the Federal Parliament and final revisions are expected to be completed and approved in summer 2006 with the Act implemented as early as 2007. The major changes include the introduction of:

- a qualified investor concept;
- new legal forms for funds (e.g. Swiss SICAVs, Swiss partnerships for hedge funds and venture capital) funds;
- dual approval (i.e. products and asset managers/promoters of Swiss collective investment schemes would all need to be authorised);
- a prime broker concept (with foreign prime brokers being acceptable);
- a simplified prospectus regime; and
- an extension of the simplified approval and authorisation process, currently available for institutional funds, to retail funds.

The changes, if enacted in their current form, would also eliminate the current requirement for a written contract covering the sale of units in single-manager hedge funds or fund of hedge funds.

Hedge fund managers are not currently regulated unless they are the formal fund management company ('Fondsleitung') of Swiss investment funds or a regulated bank or securities dealer. To compensate for the absence of regulatory supervision for unregulated fund managers of foreign collective investment schemes (including hedge funds), the Federal Banking Commission intends to regulate these fund managers under existing rules relating to securities dealers as an interim measure, until CISA is enacted.

The approval process for the distribution of EU-domiciled products in Switzerland is relatively straight-forward.

Retail investors may invest in the shares of fund-of-hedge funds that are closed-ended non-regulated listed investment companies. Open-ended domestic hedge funds or fund-of-hedge funds regulated under the IFA and foreign hedge funds approved for distribution in Switzerland may be sold to retail, high net worth and institutional investors. Hedge funds that are not approved in this manner may not be publicly marketed. However, they can be sold to institutional investors via private placement and to all types of investors in connection with a discretionary management contract, provided that hedge funds form part of an overall asset allocation by the wealth manager for the specific investor profile.

From 1 April 2006, an amended rule approved the distribution of non-approved hedge funds to high net worth investors on the basis of a non-discretionary investment advisory contract if the investors provide evidence of their net worth of CHF5 million (minimum).

Another amendment to current banking and wealth management regulation of interest to the hedge fund industry came into force on 1 January 2006, allowing for investments in non-precious metals and commodities via collective investment schemes, provided such investments are made on the basis of a discretionary management contract for overall portfolio diversification and that physical delivery is not possible.

Taxation

Individual investors in domestic distributing hedge funds are taxed on a receipts basis, with a tax refund for any withholding tax (35%) levied by the fund on the distribution. The applicable tax rate for individual investors for this income is between 25% and 55%, depending on the canton where the individual investor is resident. Individual investors in domestic accumulating funds are taxable on deemed income distributions. Capital gains distributed/accumulated by funds are tax-exempt provided, sufficient information, is provided to Swiss tax authorities and the investment is held as a private asset.

Corporate, pension fund, bank and insurance company investors in domestic distributing funds are taxed on income and capital gains distributed. The average applicable tax rate is between 16% and 25%, depending on the canton where the company is domiciled and on any special tax status of the company. Accumulated income is not subject to tax on an unrealised basis. Pension funds may be exempt from income tax if certain conditions are satisfied.

Individual investors in a capital gain-oriented domestic fund-of-hedge funds (transparent for Swiss tax purposes) that derives 98% of income from capital gains are deemed to derive capital gains, which are not subject to income tax. Investors in other fund-of-hedge funds are taxed as if the investors had a direct investment in the underlying funds.

Income of foreign hedge funds that are organised in non-corporate form (e.g. tax transparent) are taxed at the investor level.

Any distributions from corporate foreign hedge funds that are not treated as transparent for Swiss tax purposes, are treated as dividend income in the hands of corporate and individual investors. Corporate investors may be able to apply for participation relief if certain conditions are satisfied.

TURKEY

Regulatory

The Capital Markets Board (Sermaye Piyasasi Kurulu, 'SPK') has called for consultation with interested parties on the proposed changes to the Communiqué regarding investment funds which would allow for the establishment of Turkish-domiciled hedge funds which are defined as 'High-Risk Investment Funds' that are formed in order to be marketed only to the qualified investors, such as investment funds, REITs, brokerage houses, banks, insurance companies, portfolio management companies, pensions etc. High-Risk Investment Funds would be:

- Available for subscription only by qualified investors which includes a wide range;
- Able to set any minimum investment amount (including no investment amount);
- Able to determine the number of investors;
- Able to set their own investment strategies and any concentration limits without reference to the regulations applicable to other regulated investment funds, and
- Able to declare their price on a monthly basis as opposed to daily basis applicable to other regulated investment funds.

Tax

Under the current legislation there is no specific taxation treatment for hedge funds established in Turkey nor is there any proposed legislation that will impact their attractiveness. Investment income of a hedge fund established in Turkey (as per the draft communiqué provisions discussed in the regulatory section) is exempt from corporate tax. However, 15% withholding tax is applied on its investment income at source.

The corporate tax exempt income of a hedge fund is also subject to 15% withholding tax. Taxes withheld at source on its investment income (i.e.15%) are offset against 15% withholding tax applied on the corporate tax exempt income leading to an effective tax rate of 15% on income, excluding the effect of 15% tax on non-realised taxable gains.

Individual investor's income (including residents and non-residents) and non-resident corporate investors (without a permanent establishment in Turkey and that do not have any other sources of income in that particular year for which tax filing is required) from a local hedge fund is not subject to any further taxation other than the 15% withholding tax levied at the level of the hedge fund. Resident corporate investors and non-resident corporate investors that have permanent establishment in Turkey are subject to taxation on income derived from a local hedge fund as part of their ordinary corporate income. The current corporation tax rate is 30% but is expected to be reduced to 20% under the draft corporate tax law effective from 1 January 2006.

Whereas income derived by resident individual investors from a foreign hedge fund is subject to income tax through filing of an annual income tax return and is subject to progressive income tax rates that vary from 15% to 35%. Double tax treaties may however provide relief for taxation in Turkey. As in the case of local hedge funds, resident corporate investors (including banks and insurance companies) and non-resident corporate investors that have a permanent establishment in Turkey are subject to taxation on income derived from foreign hedge funds as part of their ordinary corporate income. Taxes paid offshore can be offset against the Turkish taxes subject to certain conditions.

UNITED KINGDOM

Regulation

The UK Financial Services Authority introduced revised rules for authorised funds in early 2004. These rules introduce two new classes of authorised fund in addition to the existing UCITS funds: 'non-UCITS retail schemes', aimed at the retail consumer and expanding the range of eligible assets to include property and gold; and 'Qualified Investor Funds', aimed at institutional/expert investors with minimal restrictions as to eligible assets and gearing.

The revised regime for authorised funds, including UCITS, permits the use of derivatives for investment purposes as well as short selling, provided that the short position is liquid and can be cash-settled or is covered by long positions with a return profile that is highly correlated to that of the short position.

Restrictions on gearing mean that not all the characteristics of a hedge fund can be fully employed in an authorised scheme but, nevertheless, hedge fund-like products can now be promoted to retail customers.

In June 2005, the FSA issued two discussion papers of relevance to the hedge fund sector. The first of these ('Wider-range Retail Investment Products Consumer protection in a rapidly changing world') sought to obtain market participants' views on expanding the types of sophisticated products on offer in the UK retail market. The second discussion paper ('Hedge funds: A discussion of risk and regulatory engagement') focused specifically on hedge funds, as its title suggests.

The FSA issued its feedback to responses received to these discussion papers in March this year. The feedback papers indicate that the FSA is sensitive to the commercial impact of imposing additional regulatory burdens upon the hedge fund industry, noting that it has no desire to see London's hedge fund managers move offshore, that the FSA plans to undertake increased data collection from hedge fund managers via regulatory returns, and that asset valuation and side letters are key areas for further focus. Any enhanced data collection would need to be appropriately justified, especially at a time when the FSA wishes to be seen to be streamlining data collection from firms.

A dedicated supervisory team has been set up by the FSA to oversee the hedge fund industry in the UK and this team will play a major role in analysing any additional data that will be obtained as well as in performing themed visits, particularly at the largest 25 hedge fund managers operating in the UK. The visits will focus on valuation methodologies, including the role of the hedge fund manager in valuing positions, and disclosure to clients of the existence of side letters. In both cases, the FSA will be interested in how conflicts of interest might arise and how these are managed in practice.

A further consultation paper was issued by the FSA in March 2006 ('Implementation of the Transparency Directive/Investment Entities Listing Review') in which the regulator floated its proposals for, among other things, relaxing the diversification requirements for investment entities listed on the main market of the LSE. The proposed changes to the listing rules for such entities, if enacted in line with the FSA's proposals, is likely to be one of the key methods by which 'wider-range' investment products enter into the UK retail market, reflecting the FSA's feedback to responses received to the discussion paper on wider-range products in 2005. The period for consultation on the paper issued in March 2006 closes on 30 June 2006.

Taxation

Individual investors are taxed at up to 32.5% on dividends from non-transparent overseas hedge funds. Individual investors will also be subject to tax on non-dividend income and capital gains up to 40%.

Corporations are subject to 30% tax on income derived from an offshore hedge fund. For corporate investors, the return from a foreign hedge fund may be taxed on an annual mark-to-market basis in certain circumstances, in which case the offshore fund rules (see below) do not apply. Pension fund investors are exempt from tax.

Open-ended investment companies (OEICs) and authorised unit trusts are taxed at 20% on income, but are not subject to tax on capital gains on disposal of investments. Unauthorised unit trusts are taxed at 22% on income. The new regulations governing the taxation of authorised funds (including Qualified Investor Schemes (QISs)) came into force from 1 April 2006.These rules set out that qualified investor schemes and retail non-UCITS funds will generally be taxed in the same manner as authorised unit trusts and OEICs.

These rules do however contain anti-avoidance rules that affect certain investors holding substantial interests in a QIS (broadly meaning that which exceeds 10%). This would require taxation of the increase in market value of the fund whether or not a distribution or disposal has been made.

Investment in a foreign hedge fund is likely to constitute an interest in an offshore fund. This means that UK resident investors may prefer the foreign hedge fund to obtain UK distributor status in order to safeguard the tax treatment of realised capital gains as opposed to having an income receipt on disposal.

USA

Regulation

As noted in Section 2 of this report, the Securities and Exchange Commission (SEC) has required (since February 2006) offshore hedge fund advisers to be registered, if the adviser has – on a look-through basis – more than 14 clients who are resident in the United States, unless an exemption is available.

An offshore adviser that is required to register with the SEC can avoid most of the substantive compliance requirements applicable to onshore advisers if it advises offshore funds only. Such offshore advisers will still be subject to examination by SEC staff, although we note that current SEC staffing constraints would seem to make the wholesale review of offshore advisers highly unlikely in the near term. Offshore advisers with no domestic clients will also not be exempt from the requirement (generally arising through the application of Rule 204-2(a) of the Investment Advisors Act) to keep certain books and records, although there are some exceptions with respect to transactions involving offshore clients.

Certain other requirements applicable to onshore advisers, including the compliance, custody and proxy voting rules under the Investment Advisers Act, would not apply to registered offshore advisers, provided that they have no US clients (other than for the purpose of determining whether SEC registration is required).

Finally, registered offshore advisers with no US clients (other than for counting purposes, as above) will not be required to adopt a code of ethics, but will be required to retain the personal securities dealing reports for so-called 'access persons' that would otherwise be required to be kept under such a code.

Taxation

Hedge funds marketed to both US and non US investors are structured through a parallel or a master-feeder fund structure. Under a parallel structure, a separate fund in a form of an offshore corporation (e.g. Cayman, BVI) is set up for U.S. tax-exempt investors such as pension funds and not-for-profit entities and a US limited partnership (LP) or a US limited liability company (LLC) fund is set up for U.S. taxable investors such as US individuals and corporations. Under the master-feeder structure the two funds described above hold their investments through another offshore corporate vehicle (the 'master fund') that makes an election to be treated as a partnership for US tax purposes. While the parallel structure normally allows for more flexibility with respect to structuring of the investments, a master-feeder structure could reduce the administrative costs as all the investments are held through one vehicle.

An LLC or an LP fund is structured as a fiscally transparent entity for US tax purposes. Investors in a fiscally transparent fund are treated as earning the income that is derived by the fund (i.e. the fund does not pay any tax itself). Also, the income earned by a fiscally transparent fund retains its character at the level of the investors. Therefore, individuals, corporates, banks and insurance companies investing in a fiscally transparent foreign-domiciled fund are taxed on the income (including capital gains) derived by the fund on an accruals basis, regardless of whether such income is distributed.

The income is taxed at graduated rates, with the highest rate being 35%. However, certain types of qualified dividends and long-term capital gains are taxable to the individual investors at the rate of 15%, depending on their income-tax bracket.

When investors dispose of their holdings in a fiscally transparent fund, capital gains may arise to the extent that the tax base of the investors in the fund (adjusted for the income allocable to the investor over the life of the fund and contributions and distributions) is different from the amount realised.

For non-fiscally transparent foreign funds there is, generally, no tax on current income or capital gains earned by the fund with respect to a particular investor, unless such an investor makes a qualified electing fund (QEF) election with respect to such fund. There are certain procedural requirements that have to be satisfied by the fund and certain information statements need to be provided in order for an investor to make a QEF election. If a QEF election is made, the investors are taxable on an accruals basis on the income that is earned by the fund.

If a QEF election is not made, tax is imposed on any gain realised on disposition of an interest in, or certain distributions from, a non-fiscally transparent fund. This tax is increased by a deferred tax amount. In general terms, the computation of the deferred tax amount attempts to subject a portion of the gain realised on a distribution or sale attributable to each year of the holding period to an interest charge and the tax at the highest applicable income-tax rate in effect for that year. Note that QEF considerations are only relevant for US investors that are subject to US tax.

As mentioned above, US tax-exempt investors invest through a non-fiscally transparent corporation fund. This is due to US unrelated business income tax (UBIT), which is imposed on certain income that is not connected with the tax-exempt purpose. UBIT liability arises with respect to income from a trade or business regularly carried on and not substantially related to a not-for-profit

USA Continued

entity's exempt purpose. UBIT liability could also arise with respect to certain debt finance property income. By investing through a non-fiscally transparent fund, US not-for-profit investors are able to isolate themselves from the UBIT liability (mainly related to the debt financed income) as the only income that they would receive from the fund would be in the form of dividends that are not subject to the UBIT.

Note that since not-for-profit investors are not subject to tax in the US, the QEF considerations are not relevant for them.

Finally, non-US managers looking to market their funds to US investors should be prepared for the significant tax-compliance costs that they will face to prepare information in accordance with US tax principles.

BAHAMAS

Regulation

Under the Investment Funds Act 2003, foreign funds wishing to distribute in the Bahamas must appoint a representative who has been approved by the Securities Commission of the Bahamas.

Consideration is being given to exempt investment managers domiciled in the Bahamas, who manage or advise investment funds that are licensed or registered under the Investment Funds Act 2003 from registration under the Securities Industry Act.

Taxation

Investors and funds are not subject to tax in the Bahamas.

BERMUDA

Regulation

The introduction of Bermuda Exempted Schemes removes the disadvantage previously encountered by local funds whose paying agents are located in a country subject to the EU Savings Directive (EUSD) or equivalent legislation. Swiss authorities have agreed that a Bermuda Exempted Scheme will not fall within the EUSD for their purposes.

Amendments to regulations governing the creation of collective investment schemes now provide that the Bermuda Monetary Authority has the sole responsibility for approving new schemes, thereby substantially decreasing the time required to incorporate a fund.

Legislation for the licensing of administrators is in progress, together with a project for the revision and consolidation of the legislation relating to collective investment schemes.

Taxation

Investors and funds are not subject to tax in Bermuda.

CAYMAN ISLANDS

Regulation

Funds are required to file certain extracts from the Offering Memorandum on application for registration with the Cayman Islands Monetary Authority (CIMA), and thereafter to file annual audited financial statements with CIMA within six months of the fiscal year-end.

Taxation

Funds, fund managers and investors are not subject to taxation in the Cayman Islands.

HONG KONG

Regulation

Hedge funds that have been authorised by the Securities and Futures Commission (SFC) in Hong Kong may be marketed to retail investors in Hong Kong. All authorised domestic funds, including authorised domestic hedge funds, are governed by the Code on Unit Trusts and Mutual Funds ('the Code') issued by the SFC. The Hedge Fund Guidelines (issued by the SFC in 2002) provide a regulatory framework for authorised retail hedge funds and cover both single-manager hedge funds and fund of hedge funds. The Hedge Fund Guidelines establish minimum subscription thresholds for different categories of hedge fund e.g. USD50,000 and USD10,000 for fund of hedge funds. Currently, 13 hedge funds (of which five are single-manager hedge funds and eight are fund of hedge funds) have been authorised by the SFC under the Hedge Funds Guidelines.

An entity providing asset management services in Hong Kong is required to be licensed by the SFC to carry out such activities in Hong Kong. The licensing requirements are set out in Schedule 5 in the Securities and Futures Commission Ordinance.

Taxation

Except under the new 'deeming provisions', which are explained below, individual and corporate investors are generally not taxed on the distributions from hedge funds if the distributions are in the form of dividends. Distribution of profits by a partnership hedge fund to its partners will not be taxed in the hands of the partners provided that the profits are taxed under the name of the partnership or the partnership does not carry on business in Hong Kong and, if it does, its profits are offshore income and/or capital gains.

Individual investors are generally not taxed on the gains on the disposal of the equity interests in hedge funds, provided that the individuals are not carrying on a business of trading in hedge funds. Corporate investors are presumed to carry on business and therefore gains on disposal of the equity interests in hedge funds will be subject to Hong Kong profits tax. However, if the gains on disposal of the hedge funds are regarded as capital gains or offshore income, no tax is payable in Hong Kong. The Hong Kong profits tax rates for individual and corporate are 16% and 17.5%, respectively.

However, if an offshore hedge fund is exempt from Hong Kong profits tax under section 20AC of the Inland Revenue Ordinance (IRO), which is a new tax exemption provision enacted on 10 March 2006, Hong Kong resident investors will be subject to 'deeming provisions' if either one of the following conditions is satisfied:

(i) the Hong Kong resident investor together with his/her associates (regardless of the residency of the associates), directly or indirectly, holds 30% or more beneficial interests in the fund; or

(ii) the Hong Kong resident investor is associated with the fund and holds, directly or indirectly, beneficial interest in the fund.

Deeming provisions will not be invoked if the fund is bona fide widely held.

If the 'deeming provisions' are invoked, the Hong Kong resident will be taxed, based on the underlying Hong Kong sourced profit of a revenue nature of the s.20AC tax exempt offshore hedge fund, regardless of whether actual distribution has been made or not.

Hedge funds authorised under s.104 of the Securities and Futures Ordinance are exempt from Hong Kong profits tax under section 26A of the IRO.

Unauthorised funds including hedge funds are also exempt from Hong Kong profits tax under section 20AC of the IRO if the following conditions are satisfied:

(i) the hedge fund is a non-resident of Hong Kong;

(ii) profits were derived from specified transactions;

(iii) the specified transactions were carried out through or arranged by a specified person; and

(iv) the hedge fund does not carry on any other trade, profession or business in Hong Kong.

Income from transactions incidental to the specified transactions is also exempt from Hong Kong profits tax to such a tax-exempt fund if the total trading receipt from the incidental transactions is not more than 5% of the total trading receipts from specified transactions and incidental transactions.

Hedge funds do not qualify for Hong Kong profits tax exemption under sections 20AC and 26A of the IRO will be subject to Hong Kong profits tax if:

(i) the hedge funds, directly or indirectly, carries on a trade or business in Hong Kong; and

(ii) Hong Kong sourced profits of revenue nature are derived from such trade or business.

Profits sourced outside Hong Kong and capital gains are not taxable in Hong Kong.

GULF CO-OPERATION COUNCIL ('GCC') COUNTRIES

Regulation

The Dubai Financial Services Authority (DFSA) issued a consultation paper in February 2006 relating to its proposals for the regulation and distribution of collective investment schemes. This is the latest in a long line of consultations as the DFSA assumes its powers. The consultation period ended on 9 March.

While the paper addressed CISs generally, it also contained specific references to the distribution of hedge funds. The DFSA's proposals mirror much of the existing regulatory framework, for example limitations on promotion, requirements for risk assessment, independence in relation to the calculation of the NAV, and the DFSA is to issue a code of practice once the generic regulatory regime for CIS is in place. Overall, however, the DFSA's proposals would not seem to act as an impediment to anyone wishing to promote hedge funds in the region.

There is however one aspect upon which DFSA will need to provide clarity: as currently drafted, the text appears to permit only the distribution of funds domiciled in a 'recognised jurisdiction'. A recognised jurisdiction is one which is, inter alia, a signatory to the IOSCO framework – The Cayman Islands are not a signatory to this framework and this would seem to preclude the distribution of Cayman-domiciled funds. It would be possible for the DFSA to find a way around this apparently substantive issue by clarifying whether, in the case of master-feeder structures, it is the domicile of the master fund or that of the feeder fund that is of relevance.

Taxation

General

The tax environment in the GCC countries ranges from quite straightforward to complex. Where in force, the tax laws tend to penalise foreign activities in the region.

UAE

- There are no federal taxes in the UAE. Instead, most of the Emirates introduced individual (general) income-tax decrees in the late 1960s. In practice, however, the general tax decrees have not been enforced to date and consequently, tax is not actually levied under these decrees for most businesses operating in the UAE.
- There are certain exceptions to this general position, e.g. oil producing activities (taxed at up to 50%) and branches of foreign banks (taxed at 20%).

QATAR

Generally, profits arising as a result of 'activities' in Qatar are taxed at rates of up to 35%. However, a Qatari's share of profits is exempt from tax.

KUWAIT

Kuwait has a corporate income-tax rate of up to 55%. Where proper accounting records are not deemed to be kept, the Kuwait tax authorities can apply a deemed taxable profit method.

BAHRAIN

There are essentially no corporate or income-tax regulations in Bahrain.

KINGDOM OF SAUDI ARABIA

- A new tax law has recently been introduced in KSA. As a result there is some degree of uncertainty over many tax issues in KSA.
- The new tax law essentially addresses two types of taxes on income taxes (at a flat rate of 20%) and withholding taxes on any payments made outside the Kingdom, again at rates of up to 20%.

OMAN

Local companies are taxed at a reduced income-tax rate of 12% on all profits over RO 30,000. This is compared to a top rate of tax of 30% for foreign-owned entities (i.e. branches).

NETHERLANDS ANTILLES

Regulation

A hedge fund domiciled in the Netherlands Antilles can be incorporated as an LLC, a private LLC or a Netherlands Antilles private LLC, all of which are subject to supervision by the Central Bank of the Netherlands Antilles.

Taxation

Netherlands Antilles private LLCs are exempt from taxation.

Individual investors, resident in the Netherlands Antilles, are deemed to receive a notional yield of 4% on hedge fund investments (held through a non-Antilles investment company or a Netherlands Antilles exempt company), which is taxed at the rate of 19.5% (in case of 5% shareholding or more in the hedge fund) or at maximum 49.4% (in case of shareholding lower than 5% in the hedge fund). Distributions of actual income and gains are not taxable.

Banks, insurance companies and corporate entities are taxed on income and capital gains from hedge fund investments at a profit tax rate of 34.5%. A 95% participation exemption may be available in respect of investments of 5% or more in foreign hedge funds, or 5% or more in Netherlands Antilles exempt companies or investments in hedge funds with a cost price of at least ANG1 million (approximately USD561,798). Insurance companies may also opt for a special regime under which only the premium income is subject to profit tax.

SOUTH AFRICA

Regulation

Hedge funds are unregulated and may not be marketed to retail investors at present. However, the Financial Services Board (FSB), has proposed that new regulations will be introduced soon. It is expected that the regulations will make provision for the marketing of regulated hedge fund products within certain guidelines. There is still uncertainty as to whether all funds will have to comply with the regulations or whether regulated and unregulated funds will be allowed to coexist. Hedge fund managers will be regulated by the Financial Advisory and Intermediary Services Act (FAIS) and hedge funds are expected to be regulated through the Collective Investments Schemes Control Act (CISCA).

The draft regulations relating to hedge funds have not yet been published for comment. As a consequence, the FSB's future approach towards foreign funds is also still unclear. It is likely that foreign funds will only be allowed to be marketed in South Africa if they are domiciled in FSB-approved jurisdictions such as Ireland, the UK and the Channel Islands, where the regulatory framework is deemed to be in line with the regulatory framework to be introduced in South Africa. Investment in foreign hedge funds by regulated hedge funds may also be restricted to those hedge funds domiciled in FSB-approved jurisdictions. The current uncertainty around the future tax treatment of hedge funds appears to be one of the main issues delaying progress.

Currently, hedge fund managers are authorised by the FSB as Discretionary Financial Services Providers under FAIS. This is the category into which a traditional discretionary investment manager also falls. The FAIS is expected to be amended within the next few months to introduce a distinct category to accommodate hedge fund managers. Following the change, hedge fund managers are likely to be subject to more stringent 'fit and proper' requirements than those expected of traditional investment managers and will have a separate code of conduct.

Taxation

There is still much uncertainty in South Africa regarding the tax treatment of hedge funds. Generally, domestic hedge funds are operated as tax transparent partnerships or trusts with investors participating as limited partners or beneficiaries and subject to tax on income and gains on an accruals basis.

Individual investors are taxed on income and 25% of capital gains (if not viewed as a trader) at marginal rates of up to 40%. Companies, banks and insurance companies (except certain policyholder funds) are taxed on income and 50% of capital gains at 29%, while pension funds are taxed on only certain streams of income (e.g. interest, certain dividends and net rental income) at 9% with effect from 1 March 2006 (previously 18%).

Investors in corporate foreign hedge funds are taxed on income derived by the foreign fund. Capital gains on disposal of interests in foreign hedge funds are subject to tax as either revenue or capital gains.

Investors in non-corporate foreign hedge funds are taxed on their share of the fund's income and expenditure.

The Revenue Service is waiting for the regulations referred to above to be finalised before determining the appropriate tax treatment for domestic hedge funds. To date, it is unclear whether existing unregulated domestic hedge funds would obtain any tax relief upon conversion to an approved legal structure under the pending regulations if asset transfers are required.

It is also unclear whether domestic hedge funds will be treated in a similar manner to other collective investment schemes, which are effectively treated as tax transparent at the fund level, with investors only being subject to tax when income is declared or when units are redeemed.

Table 1 – Availability of hedge funds and funds-of-hedge funds to investors by country at June 2006

Country	Single strategy hedge funds			Fund-of-hedge funds			Minimum investment amount?	Average time taken to set up a fund?
	Domestic	EU-domiciled?	Other domiciles?	Domestic	EU-domiciled?	Other domiciles?		
Austria	✗	✓	✓	✓	✓	✓	nil	Approximately 4 to 6 months
Bahamas	✓	✓	✓	✓	✓	✓	N/A	Professional funds – 3 days. Recognised foreign funds – 1 day. SMART Funds – for an approved template will vary between 2 days and 1 week. Standard funds – 4 weeks
Belgium	✗	✗	✗	✗	✗	✗	N/A	N/A
Bermuda	✓	✓	✓	✓	✓	✓	$ nil (retail) $100,000 (Institutional)	2 days if the manager has a presence in Bermuda; up to 5 days otherwise.
Cayman Islands	✓	✓	✓	✓	✓	✓	$50,000 (Cayman-regulated funds) $nil (retail)	1 day for Cayman-regulated funds
Denmark	✓	✓	✓	✓	✓	✓	Depends on type of investors the fund is marketed to and the type of fund.	6 to 8 weeks from filing all required documents with the Danish Financial Supervisory Authority.
Finland	✓[1]	✓	✓	✓	✓	✓	€nil - funds may set own requirements of minimum amounts	4 to 6 months. [2, 3]
France	✓	✓	✓	✓	✓	✓	€10,000 for fund-of-hedge funds. Generally either €125,000 or €250,000 for single-manager funds.	Once the manager is authorised by the Autorité des Marchés Financier (AMF), it may take a further 3 to 6 months to set up a single manager hedge fund.
Germany	✓	✓[5]	✓[5]	✓	✓	✓	€nil	Domestic hedge funds and fund-of-hedge funds: 3-6 weeks. [4] Foreign fund-of-hedge funds: maximum 4 months. [5]
Gibraltar	✓	✓	✓	✓	✓	✓	Depends on type of investors the fund is marketed to and the type of fund.	2 months.
Greece	✗	✓[6]	✓[6]	✗	✓[6]	✓[6]	N/A	N/A
Guernsey	✓	✓	✓	✓	✓	✓	Depends on type of investors the fund is marketed to and the type of fund.	Regulatory approval has been reduced to 3 days for Qualifying Investor Funds.
Hong Kong	✓	✓	✓	✓	✓	✓	The minimum level of initial subscription by each investor must not be less than USD50,000. For FoHFs, the minimum level of initial subscription must not be less than USD10,000.	Approximately 1 to 3 months.
Ireland	✓	✓	✓	✓	✓	✓	Single-manager hedge funds: [6] €125,000 or €250,000	6 to 8 weeks
Isle of Man	✓	✓	✓	✓	✓	✓	£nil	3 days
Italy	✓	✗	✗	✓	✗	✗	€500,000	6 to 8 months
Jersey	✓	✓	✓	✓	✓	✓	$nil or $100,000[7]	3 days
Liechtenstein	✗	✓	✓[8]	✓	✓	✓[8]	CHF nil	3 months
Luxembourg	✓	✓	✓	✓	✓	✓	€nil	2 to 3 months
Malta	✓	✓	✓	✓	✓	✓	US$20,000 or US$100,000 depending on type of investors the fund is marketed to.	3 to 4 weeks from filing of all required documents with the Malta Financial Services Authority.
Netherlands	✓	✓	✓	✓	✓	✓	€nil	3 to 6 months[9]
Netherlands Antilles	✓	✓	✓	✓	✓	✓	$nil	2 to 4 weeks
Norway	✗	✗	✗	✗	✗	✗	N/A	N/A
Portugal	✓	✓	✓	✓	✓	✓	€15,000 or € 30,000[10]	1 to 2 months for a straight forward fund; longer for more complex funds
Russia	✗	✗	✗	✗	✗	✗	N/A	N/A
South Africa	✓	✓	✓	✓	✓	✓	ZAR nil [11]	No regulatory time period, but current structures can be complex to avoid being classified as a collective investment scheme.

Table 1 – Availability of hedge funds and funds-of-hedge funds to investors by country at June 2006

Country	Single strategy hedge funds			Fund-of-hedge funds			Minimum investment amount?	Average time taken to set up a fund?
	Domestic	EU-domiciled?	Other domiciles?	Domestic	EU-domiciled?	Other domiciles?		
Spain	✓[12]	✓	✓	✓	✓	✓	€50,000 [12] (institutional only)	Standard regulatory 3 month period for authorisation of collective investment undertakings. However, no practical examples exist until the new complete regulatory framework allows the effective launching of such products.[13]
Sweden	✓	✓	Possibly	✓	✓	Possibly	SEK nil	Domestic hedge funds: up to six months from completing the application. Other domiciles: approximately two months.
Switzerland	✓	✓	✓	✓	✓	✓	CHF nil	3 to 9 months [15]
United Kingdom	✓	✓	✓	✓	✓	✓	£250 to £250,000	2 to 6 months.
USA	✓	✓	✓	✓	✓	✓	$ nil	3 to 6 months

TABLE 1 NOTES

Finland	1.	Hedge funds are formed as Special Funds (usually Special Common Funds).
	2.	The Financial Services Authority (FSA) must be notified or a licence must be obtained when marketing mutual funds or special common funds.
	3.	Under the Mutual Funds Act, UCITS funds may commence marketing their units two months after the submission of the relevant notification, unless the FSA has special cause to prohibit the commencement of marketing.
Germany	4.	The average time for authorisation depends on the complexity of the investment strategy and the product structure.
	5.	Only via private placement.
Greece	6.	Only via private placement, subject to the granting of a licence by the Capital Markets Committee.
Ireland	7.	Minimum investment amounts have been abolished for retail fund of hedge funds. Minimum investments are €125,000 for Professional Investor Funds (PIFs) and €250,000 for Qualified Investor Funds (QIFs).
Jersey	8.	There is no minimum investment for professional or institutional investors or investors with a net worth above $1 million. Otherwise the minimum investment is $100,000.
Liechtenstein	9.	Generally, offshore products in jurisdictions not subject to adequate regulation and supervision will not be approved for public distribution in Liechtenstein. However, such products can be invested in by regulated fund-of-hedge funds, structured products, as well as by professional wealth managers and banks who manage customer accounts under a discretionary management agreement, provided hedge funds form part of the regular asset allocation for the relevant client category that a particular client of a given asset manager falls into.
Netherlands	10.	The period stated is for funds established in an EU country or in a non-EU country in which there is adequate supervision according to the Authority for the Financial Markets (AFM). The AFM has determined that currently only a limited number of countries provide adequate supervision, including the United States.
Portugal	11.	The minimum investment amount depends on the type of investments that the fund holds.
South Africa	12.	The Financial Services Board issued a discussion paper to assist in drafting hedge fund regulations. The paper asks whether an amount of ZAR250,000 should be considered reasonable as a minimum investment amount in a single-strategy hedge fund and suggests that regulated fund-of-hedge funds might have no minimum investment amount.
Switzerland	13.	Authorisation of simple fund-of-hedge funds by an existing manager/promoter usually takes less time than more complex (multi strategy multi-manager products or single-manager funds) or products from managers/promoters who are new to the local fund market.

Table 2 – Channels of distribution of hedge funds by country at June 2006

Country	Main marketing channels: Banks	Fund distribution companies	Via Wrappers	Private placements	Investment managers	Other regulated financial services institutions	Non-regulated financial intermediaries	Summary of regulations currently governing distribution of hedge fund products and significant non-tax barriers to development of new distribution channels	Restrictions on location of key service providers?
Austria	✓	✓	✓	✓				If a foreign hedge fund qualifies as an investment fund within the meaning of the Austrian law, public distribution will require the permission of the Austrian Financial Market Authority (FMA). Such permission will not be granted where the fund undertakes uncovered short selling or if investors may be called upon to make additional contributions.	✗
Bahamas				✓	✓			Hedge fund products not generally available to retail investors in the Bahamas.	✓[1]
Belgium	✓		✓	✓				Domestic legislation effectively prevents the establishment of domestic hedge funds. Public distribution of foreign hedge funds and fund-of-hedge funds is not permitted.	✗
Bermuda	✓			✓	✓			Distribution to retail investors is governed by the Collective Investment Scheme Act.	✓[2]
Cayman Islands	✓			✓	✓			Cayman-domiciled funds are generally not available to retail investors in the Cayman Islands.	✓[3]
Denmark	✓			✓	✓			Full FSA approval is required for distributing domiciled funds and funds domiciled outside the EEA. Other hedge funds registered in EU countries must give notice to the Danish FSA before cross-border distribution.	✗[4]
Finland	✓	✓			✓			The Mutual Funds Act on Common Funds governs the distribution of Common Funds (UCITS) and Special Common Funds (non-UCITS). Domestic hedge funds are generally formed as SCFs. The Securities Market Act governs distribution of non-Finnish funds that are available only to institutional investors (for which no marketing licence is required. The FSA must be notified prior to the commencement of marketing of UCITS funds. Non-EU mutual funds marketing their units to retail investors must obtain a licence from the FSA.	✗
France		✓	✓	✓	✓			Hedge funds and hedge fund-like products are regulated as either Authorised Funds with Simplified Investment Rules (OPCVM Agreés a Regles d'Investissement Allégées – ARIA) or Contractual Mutual Funds (OPCVM Contractuels) under the Financial Securities Act of 2004 and may be marketed to different categories of investors including retail investors.	✗[5]
Germany	✓[6]					✓	✓[7]	Single-strategy hedge funds may not be distributed to retail investors. Fund-of-hedge funds, whether foreign or domestic, may be distributed to retail investors with the permission of BaFin. **Wrapper products** Generally, aside from the duty to publish a prospectus, publicly distributed wrapper products are not subject to direct supervision. However, it has recently been debated whether offshore issuers of such products are required to comply with licensing requirements applying to the cross-border provision of banking services.	✓[6]
Gibraltar								None.	✓[9]
Greece				✓				Domestic funds are regulated according to their legal form, however Greek legislation effectively prevents the establishment of domestic hedge funds. All non-UCITS funds seeking to distributed to retail investors are required to obtain a licence from the Capital Markets Committee. Distribution of foreign hedge funds tends to be by private placement only and outside the scope of the regulatory framework.	✗
Guernsey	✓	✓	✓	✓	✓	✓		No significant barriers noted.	✗
Hong Kong (i) Retail funds	✓	✓			✓	✓		Hedge funds which are marketed to the Hong Kong public must be authorised by the Securities and Future Commission in Hong Kong.	✗
(ii) Private funds				✓	✓	✓			
Ireland	✓[10]			✓		✓[11]		Hedge funds domiciled outside Ireland, which are seeking to market publicly in Ireland, must be approved by the Financial Regulation.	✓[12]
Isle of Man		✓	✓[13]	✓	✓			Hedge funds can be distributed worldwide, subject to the rules of the territory in which they are being sold.	✓[14]
Italy				✓				Authorisation to establish domestic hedge funds (single-strategy and fund-of-hedge funds) is granted by the Bank of Italy, who must approve the fund's constitutional documents. Hedge funds may not be offered publicly in Italy.	✓[15]
Jersey	✓	✓	✓	✓	✓	✓		If marketed within Jersey, a Distributor Permit may be required. However, if a Manager Permit is already held, this may be relied upon instead.	✗[16]
Liechtenstein	✓							Regulated open-ended Liechtenstein hedge funds or fund-of-hedge funds and foreign regulated hedge funds approved for distribution in Liechtenstein can be sold to retail, high-net-worth and institutional investors. Alternatively, a bank or other professional asset manager can distribute hedge funds and fund-of-hedge funds within the scope of an approved and disclosed formal asset allocation policy, based on a discretionary management contract with the client. The distributor of IUG-regulated funds generally either is an FMA-regulated institution or else has to obtain the FMA's approval as a distributor. Furthermore, hedge funds and fund-of-hedge funds not approved for distribution in Liechtenstein may form part of the asset allocation policy applied to clients' portfolios managed under discretionary management contracts, and can be sold to investors on their own request, but must not be publicly advertised or promoted.	

Table 2 – Channels of distribution of hedge funds by country at June 2006

Country	Main marketing channels: Banks	Fund distribution companies	Via Wrappers	Private placements	Investment managers	Other regulated financial services institutions	Non-regulated financial intermediaries	Summary of regulations currently governing distribution of hedge fund products and significant non-tax barriers to development of new distribution channels	Restrictions on location of key service providers?
Luxembourg	✓					✓		Hedge funds domiciled outside Luxembourg seeking to market to the public in Luxembourg must be approved by the Commission de Surveillance du Secteur Financier ('CSSF'). Only funds which are subject to adequate prudential supervision in their country of origin will be approved.	✗
Malta	✓	✓		✓		✓		In order for hedge funds to be marketed in Malta, they must first be approved by the Malta Financial Services Authority.	✓[17]
Netherlands			✓		✓	✓		The Act on the Supervision of Collective Investment Schemes or 'ASCIS' provides licence requirements for investment vehicles.	✓[18]
Netherlands Antilles				✓				Netherlands Antilles – domiciled funds are generally not available to retail investors in the Netherlands Antilles.	✓
Norway								Under current regulations, foreign hedge funds may only be actively promoted in Norway with the permission of the Norwegian Financial Supervision Authority (FSA). We are not aware of any foreign hedge fund that has been granted permission by the FSA to be promoted in Norway. The Ministry of Finance has issued a consultation paper proposing to allow hedge funds to be marketed to professional investors. The consultation period ended in April 2005. Currently, the Securities Fund Act prohibits the solicitation of subscriptions in hedge funds, from both individuals and legal entities.	
Portugal	✓							**Domestic/EU-domiciled fund** Special Investment Funds (SIFs) may be distributed only to specific investors as defined in their constitutional documents. CMVM may refuse to authorise the distribution of SIFs to certain investor types if it has concerns that a fund will not adequately protect investors. **Non-EU-domiciled fund:** Non-EU domiciled funds are also required to be authorised by CMVM prior to distributing publicly in Portugal. Authorisation will not be granted where the fund does not provide adequate protection to investors or where it is proposed that marketing of the fund will not conform to the rules applicable to UCITS.	✓[19]
Russia				✓				Hedge funds may only be distributed by private placement.	✗
South Africa	✓		✓	✓	✓			Hedge fund managers are not currently allowed to actively solicit investments into their funds. The restriction on marketing covers foreign hedge funds sold in South Africa as well as domestic hedge funds. Pending regulations are likely to provide for the distribution of hedge funds under the FAIS Act. Banks and insurance companies currently dominate distribution. A collective investment scheme managed outside South Africa, must at all times have a representative office in South Africa and maintain a minimum capital amount of ZAR2 million (invested in liquid assets) in order to distribute in South Africa.	✓
Spain	✓			✓	✓	✓[20]		Under Spanish legislation, access to domestic or foreign single-manager hedge fund products are confined to qualified investors as defined under the Prospectus Directive. Retail investors may invest in domestic fund of hedge fund products subject to certain conditions and representations about their knowledge about the risk of such type of products. Any category of foreign hedge fund product, which intend to distribute shares/units in Spain under the same conditions as those prescribed for Spanish products is prior authorisation of the CNMV.	✓[21]
Sweden	✓				✓	✓		Activities aiming to further the sale of any product or service in Sweden, including securities and fund shares, are subject to the provisions of the Swedish Marketing Practices Act.	✓[22]
Switzerland	✓	✓	✓		✓	✓		There are no restrictions for retail investors to invest in shares of closed-ended non-regulated listed investment companies (fund of hedge funds). IFA-regulated open-ended Swiss hedge funds or fund-of-hedge funds and foreign-regulated hedge funds approved for distribution in Switzerland can be sold to retail, high-net-worth and institutional investors. Alternatively, banks and other professional asset managers can distribute hedge funds and fund-of-hedge funds based on a discretionary management contract with clients. Distributors of IFA-regulated funds are either a FBC-regulated institution or are required to obtain the FBC's approval as a distributor prior to commencing distribution. Hedge funds and fund-of-hedge funds not approved for distribution in Switzerland may be sold to investors in connection with a discretionary management contract, or by private placement to institutional investors. As from 1 April 2006 distribution to high net worth individuals (with a net worth of more than CHF5 million) on the basis of a non-discretionary investment advisory agreement will be permissible.	✓[23, 24]
UK	✓		✓	✓	✓			Hedge funds should not be promoted to the public. However, there are a number of products that are aimed at, and promoted to, the retail market in the UK with hedge fund exposure. These have typically been structured as UK-listed companies, which are fund of funds.	✗
USA				✓				In the USA, marketing rules governing hedge funds are covered by: (1) the rules of the SEC, which govern much of the activities of investment advisors (2) State / Blue Sky regulations (3) The rules of the NASD, which regulate the offering of hedge funds by registered representatives of broker dealers who offer hedge funds. The majority of hedge funds and fund-of-hedge funds are sold via private placements, however funds may register with the SEC and be offered more widely.	✗

TABLE 2 NOTES

Bahamas	**1.**	Foreign funds must appoint a representative in the Bahamas who is approved by the Securities Commission.
Bermuda	**2.**	The custodian and administrator must be located in Bermuda for Bermuda-domiciled retail funds, although the Bermuda Monetary Authority (BMA) may grant exemptions or permit services to be sub contracted outside Bermuda in certain circumstances. No restriction exists for institutional funds, if service providers are considered 'fit and proper' by the BMA.
Cayman Islands	**3.**	Funds registered with CIMA are required to appoint a local CIMA-approved auditor.
Denmark	**4.**	Domestic hedge associations are required to appoint a bank as the depository. This bank is required to have its registered office in Denmark or be a corresponding foreign credit institution with a branch in Denmark and with its registered office within the EU or EEA.
France	**5.**	The custodian must be located in EU.
Germany	**6.**	Banks may distribute overseas hedge funds by issuing wrapper products.
	7.	Only fund-of-hedge funds may be distributed by non-regulated financial intermediaries.
	8.	For domestic funds, both the investment manager and custodian bank are required to be located and regulated in Germany.
Gibraltar	**9.**	The custodian, investment manager and trustee must be registered in Gibraltar and must be regulated.
Ireland	**10.**	Private banks only.
	11.	Brokers only.
	12.	Irish-domiciled hedge funds must appoint an Irish trustee/custodian and fund administrator and perform certain other tasks in Ireland.
Isle of Man	**13.**	Wrapper products issued by insurance companies only.
	14.	Day-to-day operations of Professional Investor Funds and Experienced Investor Funds must be carried out in the Isle of Man.
Italy	**15.**	The depository bank for Italian hedge funds must be located in Italy, however this could be an Italian bank or a branch of an EU bank located in Italy.
Jersey	**16.**	Provided that the fund is established under the Expert Funds regime.
Malta	**17.**	The custodian/prime broker, administrator, manager and advisor appointed by the Fund must be located in an established, regulated and recognised jurisdiction, which include members of the EU or EEA and some third countries.
Netherlands	**18.**	Outsourcing of services to external service providers by a regulated investment vehicle is possible provided certain restrictions are met. The investment manager remains responsible for the outsources activities and outsourcing may not hinder supervision. Outsourcing of the execution of the investment policy is only allowed to regulated entities. There must be an outsourcing agreement in place that meets certain requirements.
Portugal	**19.**	Domestic funds must appoint a local bank or a branch of an EU bank as custodian. It is possible for the investment management of domestic funds to be performed outside Portugal where regulation in the country of the investment manager is deemed by the Portuguese regulator to be of an acceptable standard.
Spain	**20.**	ISD Firms and financial intermediaries.
	21.	Domestic funds must appoint a local bank or a branch of an overseas bank in Spain as Custodian. Additionally, regulations are to be adopted will require that any outsourcing entity can demonstrate appropriate experience in performing the outsourced activity.
Sweden	**22.**	Funds must have a domestic paying agent for the settlement of subscriptions, redemptions, distributions.
Switzerland	**23.**	Domestic hedge funds and fund-of-hedge funds subject to the Investment Fund Act (IFA) must appoint a local custodian bank and a local administrator.
	24.	Foreign hedge funds and fund-of-hedge funds approved for distribution are required to appoint an approved representative and a domestic paying agent for the settlement of subscriptions, redemptions, distributions.

Table 3 – Regulation of hedge fund managers by country at June 2006

Country	Name of regulator	Minimum capital required to operate as hedge fund manager	Notes
Austria	Finanzmarktaufsicht (FMA)	Varies	1
Bahamas	Securities Commission of The Bahamas	$25,000	
Belgium	Banking, Financial and Insurance Commission	N/A	2
Bermuda	Bermuda Monetary Authority (BMA)	None	3
Cayman Islands	Cayman Islands Monetary Authority (CIMA)	Cayman-domiciled investment managers must register under the Securities Investment Business Law (SIBL). An exemption from the normal US$500,000 minimum capital requirement is available where the funds being managed are only open to institutional and high net worth investors.	
Denmark	Danish Financial Supervisory Authority	Total assets of at least DKK25 million (approximately €3.3 million) not including intangible assets.	
Finland	Financial Supervision Authority (FSA)	€125,000. plus 0.02% of assets under management in excess of €250 million (subject to an overall maximum capital requirement of €10 million).	
France	Autorités des Marchés Financiers (AMF)	Net equity must be maintained at a level equal to the greater of: - 25% of annualised expenditure; and - €125,000 + 0.02 % of asset under management in excess of €250 million	
Germany	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	Initial capital of at least €730,000 plus an ongoing capital requirement based on assets under management. Own funds shall at no time be less than 25% of annual operating expenses.	
Gibraltar	Financial Services Commission (FSC)	€50,000 to €750,000, depending on the nature and scope of the activities undertaken.	
Greece	N/A	N/A	
Guernsey	Guernsey Financial Services Commission (GFSC)	£10,000 of paid up share capital if no staff or premises, otherwise the higher of £25,000 and 3 months' expenditure.	
Hong Kong	Securities and Futures Commission (SFC)	Minimum paid-up share capital: HK$5,000,000 to HK$30,000,000 minimum liquid capital: HK$100,000 to HK$15,000,000, depending on the nature and scope of the activities.	
Ireland	Irish Financial Services Regulatory Authority (IFSRA)	Usually €50,000 initial capital plus 3 months of annualised expenditure.	4
Isle of Man	Financial Supervision Commission (FSC)	The greater of £75,000, or 3 months' expenditure.	
Italy	Bank of Italy; Commissione Nazionale per le Società e la Borsa	€1,000,000 (although this can be larger depending on the nature and scale of investment management activities).	
Jersey	Jersey Financial Services Commission (JFSC)	£25,000	
Liechtenstein	Finanzmarktaufsicht (FMA)	Varies	5
Luxembourg	Commission de Survéillance du Secteur Financier (CSSF)	€125,000 (Type 2 managers); €1,500,000 (Type 3 managers)	6
Malta	Malta Financial Services Authority	€125,000 (for category 2 licence holders) plus a liquidity requirement of 25% of annual expenditure	
Netherlands	Authority for the Financial Markets (AFM) for supervision of market conduct. Dutch Central Bank for prudential supervision.	€225,000 (non-UCITS manager)	
Netherlands Antilles	Central Bank of Netherlands Antilles	N/A	
Norway	Financial Supervisory Authority of Norway	€125,000	
Portugal	Portuguese Securities Market Commission (CMVM)	(i) €250,000 (share capital) plus a requirement based on assets under management. (ii) €7,500,000 (own funds) for managers of closed-ended vehicles.	7
Russia	N/A	N/A – hedge fund managers are not regulated in Russia.	
South Africa	N/A	N/A – hedge fund managers are not regulated in South Africa	8
Spain	Comisión Nacional del Mercado de Valores (CNMV)	€300,000 plus additional own funds requirements based on the level of assets under management and their net income received from its management activities.	9
Sweden	The Swedish Financial Supervisory Authority	€125 000 initial capital. In addition, capital equal to 3 months' annualised expenditure must be maintained, plus 0.02 % of assets under management in excess of €250 million (up to a maximum capital requirement of €10 million).	
Switzerland	Federal Banking Commission (FBC), if regulated.	CHF1–10 million, depending on assets under management, if regulated.	10
UK	Financial Services Authority (FSA)	Own Funds of €50,000 plus 3 months annualised expenditure	
USA	The Securities and Exchange Commission (SEC) and, in some cases, the Commodity FuturesTrading Commission (CFTC)	None.	11

TABLE 3 NOTES

Austria	1.	The FMA is only responsible for Austrian banks and Austrian ISD firms: if a bank is the manager, the capital requirement is €5 million (€2.5 million for Austrian ManCos); if an ISD firm is the manager, the capital requirement is either €50,000 or €125,000 depending on scope of services provided.
Belgium	2.	Hedge fund managers may only operate private hedge funds. Hedge fund managers operating such funds are subject to no specific prudential controls.
Bermuda	3.	Domestic hedge fund managers are not regulated in Bermuda unless they are distributing funds to residents of Bermuda, in which case they are required to be registered under the Investment Business Act.
Ireland	4.	Promoters of Irish-domiciled hedge funds must maintain minimum regulatory capital of €635,000.
Liechtenstein	5.	The initial capital in the case of a fund management company must be at least CHF1 million. A self-managed investment company is required to have an initial capital of at least CHF500,000 (or a bank guarantee for an equivalent amount).
Luxembourg	6.	Type 2 and Type 3 managers manage non-UCITS funds domiciled inside and outside of Luxembourg respectively.
Portugal	7.	(i) €250,000 is the minimum share capital for a Sociedade Gestora de Fundos Mobiliários (SGFM) (one of the two types of entities that can be fund managers); additionally, SGFM are required to maintain own funds that are not less than the sum of 0.5% of the first €75 million of assets under management and 0.1% of any additional assets under management. (ii) For closed-ended funds, the manager is required to be a credit institution. The minimum share capital of a credit institutional depends on the nature of its main activity, e.g. banking, leasing, etc.
South Africa	8.	As the hedge fund industry in South Africa is currently unregulated, there is no minimum capital requirement for hedge fund managers. The Financial Services Board (FSB) is the regulator of collective investment schemes under the Collective Investment Schemes Control Act, 2002 (CISCA). The FSB is drafting regulations for the regulation of hedge fund managers which will fall under this Act. The current capital requirement for a manager of a regulated collective investment scheme in securities is the greater of ZAR600,000 or 13 weeks' fixed operating costs of the scheme, plus an investment of ZAR1 million in every fund under its management (although this is reduced by ZAR100,000 for every ZAR1 million invested in the funds by independent investors) and a position risk requirement based on a percentage of the amount paid for participatory interests held by the manager in funds it manages.
Spain	9.	Revised capital requirements are included in the draft legislation, which we expect will be adopted later in the year. Specific enabling legislation could be adopted in the future to create additional capital requirements for domestic hedge fund managers.
Switzerland	10.	Hedge fund managers in Switzerland are generally unregulated unless they manage a domestic hedge fund regulated under the Investment Funds Act (IFA) and at the same time act as the hedge fund's legal fund management company.
USA	11	Rules in the US generally require investment advisers to register with the SEC if they manage the assets of US clients. There are certain exemptions from registration for advisers that manage the assets of fewer than 15 clients (or for US-domiciled advisers that manage less than $25 million). The rules for counting the number of clients have been revised to count each investor in a fund as a client rather than counting each fund as a client. This rule change takes effect on 1 February 2006 and will require many more advisers to register with the SEC. Advisers who have their principal place of business outside the United States (Offshore Advisers) only need to count their US resident clients (determined at the time of initial investment) towards this 15-client threshold.

Table 4 – Taxation of hedge funds and hedge fund managers

Country	Single-strategy fund	Fund-of-hedge funds	Hedge fund manager
Austria	Fund is tax transparent		Subject to corporate income tax at the rate of 25%
Bahamas	0%		0%
Belgium	N/A		N/A
Bermuda	0%		0%
Cayman Islands	0%		0%
Denmark	Tax exempt. Subject to a final withholding tax of 15% on dividends received on shares in Danish companies.		Taxed at corporate rates
Finland	Taxable at investor level if structured as a partnership. If structured as a special common fund, the fund is tax exempt.		Income and gains taxable at 26%
France	Fund is tax transparent		Taxed at standard rates
Germany	Tax-exempt		A German-domiciled hedge fund manager in the legal form of a corporation is taxed at a flat rate of 25% corporate tax.
Gibraltar	0% (tax exempt companies) or 35%		0%
Greece	29% (expected to fall to 25%)		29% (expected to fall to 25%)
Guernsey	0% (20% on Guernsey income)		0% to 20%
Hong Kong	0% / 17.5%		17.5%
Ireland	Tax-exempt		12.5% on trading profits; 25% on non-trading income
Isle of Man	Tax-exempt		Taxed at 0%
Italy	Hedge funds are subject to tax at a rate of 12.5% on the accrued management result at the year-end. The general rule provides that income received by investment funds is gross of Italian withholding taxes at source or substitute taxes. The management result is computed on an accruals basis by adding all the income derived from investments (for instance, interest and dividends) to other income including capital gains on securities and positive spreads from derivative instruments. The management result yield is the difference between the opening net asset value and the closing net asset value of the fund. Income subject to Italian withholding tax at source and tax-exempt income is excluded from the management result and is subject to 12.5% tax.		Italian asset management companies (SGRs) are subject to corporate tax at 33% and regional tax at a 4.25% (or higher rate depending on regional laws).
Jersey	0% (20% on Jersey income)		0% to 20%
Liechtenstein	0.1% for the first CHF2 million of the fund's capital and 0.04% for the capital exceeding CHF2 millions (a tax exempt is planned to become effective 1 July 2006).		Profits taxed under normal corporate tax regime from 7.5% to 15% (up to 20% if a distribution with a sum bigger than 8% of the capital of the company is made). Capital of the company is taxed at 0.2%. Additional withholding tax of 4% must be paid on distributions of corporations.
Luxembourg	Tax-exempt, but registration duty of €1,250 and annual subscription tax of 0.01% (funds, sub-funds, funds shares dedicated to institutional investors) or 0.05% on funds NAV (For fund of hedge funds, no subscription tax is levied in respect of Luxembourg-domiciled underlying funds).		Profits taxed under normal corporate tax regime at 29.63% plus annual 0.5% Net Wealth Tax (on unitary value of the company). Capital duty of 1% is levied upon incorporation. The management company of a sole FCP and the advisory company of a sole SICAV could benefit from an exemption from income tax and net wealth tax.
Malta	Maltese-licensed hedge funds would typically have more than 15% of their investments situated overseas. Such funds are not taxed in Malta on their income or capital gains. Separate rules apply for funds having at least 85% of their investments situated in Malta.		Fund managers managing non-resident funds and local funds marketed exclusively outside Malta may qualify as international trading companies and are subject to tax at the normal corporate rate of 35% (although effective tax leakage upon distributions to non-resident shareholders is minimal due to local imputation system which would result in a refund of most of the tax paid on distributed profits).
Netherlands	Dutch funds are either transparent or subject to a special tax regime (0% corporate income tax).		Income and capital gains taxed at normal corporate rates
Netherlands Antilles	0%		Taxed at 34.5%
Norway	N/A		N/A

Table 4 – Taxation of hedge funds and hedge fund managers

Country	Single-strategy fund	Fund-of-hedge funds	Hedge fund manager
Portugal	Domestic hedge funds that qualify as mutual funds are treated as tax transparent. Withholding tax is levied on distributions at rates of 10-25% depending on type of income received by the fund.	Domestic hedge funds that qualify as mutual funds are treated as tax transparent. Distributions from underlying funds are exempt.	Taxed at normal corporate rate of 25% plus 10% (maximum) municipal surcharge.
Russia	Funds incorporated as 'units investments funds' (UIF) are not recognised as separate legal entities and are exempt from profits tax. A 2.2% property tax is payable based on the value of the fund's fixed assets by either manager or investor. Shareholder funds are subject to tax on capital gains and other income.		Taxed at 24%.
South Africa	Fund is tax transparent		Corporate managers taxed at 29%.
Spain	Corporate Tax on net profits at a 1% rate.		Corporate Tax on net profits at a 35% rate.
Sweden	Realised income taxed with the exception of capital gains on shares and share-based derivatives.		Taxed at 28% on an accrued income/loss basis.
Switzerland	Can be either tax transparent or opaque depending on form. If opaque, taxed as a corporate and if transparent, no tax at fund level.		16-25% taxed on income depending on the canton the Hedge Fund Manager is domiciled.
UK	Funds organised as OEICs/AUTs taxed on income at 20% with capital gains exempt from tax. Unauthorised unit trusts are taxed at 22%.		Corporate managers taxed at 30%. Fund managers organised as Limited Liability Partnerships taxed at Partner's marginal tax rate (up to 41%).
USA	Hedge funds marketed to US investors are structured through a parallel or master-feeder structure. Under a parallel structure, a separate fund in the form of an offshore (e.g. Cayman or B.V.I corporation is set up for U.S. tax-exempt investors such as pension funds and not-for-profit entities and a US limited partnership ('LP') or a US limited liability company (LLC) fund is set up for US taxable investors, such as US individuals and corporations. Under the master-feeder structure the two funds invest in an offshore corporate vehicle (the 'master fund') which old the investments and which makes an election to be treated as a partnership for US tax purposes. While the parallel structure normally allows for more flexibility with respect to structuring of the investments, a master-feeder structure can reduce administration costs as all the investments are held through a single vehicle.		

Contacts

PricewaterhouseCoopers' Global Alternative Investment Management Industry Group

GLOBAL LEADER

Anthony Artabane (New York) (1) 646 471 7830 anthony.artabane@us.pwc.com

EUROPEAN LEADER

Graham Phillips (London) (44) 20 7213 1719 graham.p.phillips@uk.pwc.com

AUSTRALIA
David Prothero (61) 2 8266 2916
david.prothero@au.pwc.com

AUSTRIA
Dieter Habersack (43) 1 501 88 3626
dieter.habersack@at.pwc.com
Thomas Strobach (43) 1 501 88 3640
thomas.strobach@at.pwc.com

BAHAMAS
Clifford Johnson (1) 242 302 5307
clifford.a.johnson@bs.pwc.com

BELGIUM
Emmanuele Attout (32) 2 710 4021
emmanuele.attout@be.pwc.com

BERMUDA
Andrew Brook (1) 441 299 7126
andrew.brook@bm.pwc.com

CAYMAN ISLANDS
Noel Reilly (1) 345 914 8600
noel.t.reilly@ky.pwc.com

CHANNEL ISLANDS/GUERNSEY
Simon Perry (44) 1481 719357
simon.p.perry@gbg.pwc.com

CHANNEL ISLANDS/JERSEY
David Pirouet (44) 1534 838 302
david.pirouet@gbj.pwc.com

DENMARK
Mikael Sørensen (45) 3945 9102
Mikael.sorensen@dk.pwc.com

FRANCE
Maire-Elisa Roussel (33) 1 56 57 87 86
marie-elisa.roussel@fr.pwc.com

FINLAND
Tuukka Lahkela (358) 9 2280 1333
tuukka.lahkela@fi.pwc.com

GERMANY
Robert Welzel (49) 69 9585 6758
robert.welzel@de.pwc.com
Steffen Gnutzmann (49) 69 9585 6474
steffen.gnutzmann@de.pwc.com

GIBRALTAR
Edgar Lavarello (350) 73520
edgar.c.lavarello@gi.pwc.com

GREECE
Nicos Komodromos (30) 210 6874 671
nicos.komodromos@gr.pwc.com

HONG KONG
Robert Grome (852) 2289 1133
robert.grome@hk.pwc.com

IRELAND
Damian Neylin (353) 1 662 6551
damian.neylin@ie.pwc.com
Olwyn Alexander (353) 1 704 8719
olwyn.m.alexander@ie.pwc.com
Ken Owens (353) 1 704 8542
ken.owens@ie.pwc.com

ISLE OF MAN
Mike Simpson (44) 1624 689 689
michael.simpson@iom.pwc.com

ITALY
Elisabetta Caldirola (39) 02 7785 380
elisabetta.caldirola@it.pwc.com
Lia Turri (39) 02 7785 356
lia.turri@it.pwc.com

JAPAN
Peter Finnerty (81) 35 53 22 530
peter.finnerty@jp.pwc.com

LIECHTENSTEIN
Martin Buechel (41) 58 792 2454
martin.buechel@ch.pwc.com

LUXEMBOURG
Didier Prime (352) 49 48 48 6130
didier.prime@lu.pwc.com
Laurent de la Mettrie (352) 49 48 48 3204
laurent.de.la.mettrie@lu.pwc.com

MALTA
Joseph Camilleri (356) 2564 7603
Joseph.camilleri@mt.pwc.com

MIDDLE EAST
Ashruff Jamall (971) 4 304 3105
ashruff.jamall@ae.pwc.com

NETHERLANDS
Kees Hage (31) 10 407 6414
kees.hage@nl.pwc.com

NETHERLANDS ANTILLES
Cees Rokx (599) 9 430 0000
cees.f.rokx@an.pwc.com

NORWAY
Petra Liset (47) 95 26 01 52
petra.liset@no.pwc.com

PORTUGAL
António Assis (351) 213 599 172
antonio.assis@pt.pwc.com

SINGAPORE
Justin Ong (65) 6236 3708
justin.ong@sg.pwc.com

SOUTH AFRICA
Pierre de Villiers (27) 11 797 5368
pierre.e.de.villiers@za.pwc.com

SPAIN
Antonio Greno (34) 91 568 46 36
antonio.greno@es.pwc.com

SWEDEN
Sussanne Sundvall (46) 8 555 33273
sussanne.sundvall@se.pwc.com

SWITZERLAND
Thomas Huber (41) 58 792 2436
thomas.huber@ch.pwc.com
Victor Meyer (41) 58 792 4340
victor.meyer@ch.pwc.com

TURKEY
Faruk Sabuncu (90) 212 326 6083
faruk.sabuncu@tr.pwc.com
Umurcan Gago (90) 212 326 6473
umurcanl.gago@tr.pwc.com

UNITED KINGDOM
Graham Phillips (44) 20 7213 1719
graham.p.phillips@uk.pwc.com
Robert Mellor (44) 20 7804 1385
robert.mellor@uk.pwc.com
Roger Turner (44) 2078 04 3249
roger.turner@uk.pwc.com
Jerry Dawson (44) 20 7804 2624
jerry.dawson@uk.pwc.com
Elizabeth Stone (44) 20 7804 9678
elizabeth.j.stone@uk.pwc.com

USA*
Anthony Artabane (1) 646 471 7830
anthony.artabane@us.pwc.com
Mark Casella (1) 646 471 2500
mark.j.casella@us.pwc.com
William Taggart Jr (1) 646 471 2780
william.taggart@us.pwc.com
Barry Knee (1) 646 471 5898
barry.m.knee@us.pwc.com

* Hedge find specialists in all major US cities – only main New York contacts listed.

Soft copies of this report can be obtained by visiting our website at www.pwc.com/hedgefunds

www.pwc.com

PRICEWATERHOUSECOOPERS