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Base Erosion Profit Shifting (BEPS)
The Impact on Funds

October 2014

Leading business advisors

Webinar Participants

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Agenda

1. Introduction to BEPS
2. How did it come into being? Timelines and future action items
3. Issues relevant to the Fund Industry arising from BEPS
4. Conclusion

The OECD/G20 BEPS Project

Background

Work began in 2012

- Commenced following 2012 meeting of G20 Leaders
- Political response to growing perception that governments lose substantial corporate tax revenue because of base erosion and profit shifting ("BEPS")
    - Involves governments of 44 countries:
    - 34 OECD member countries,
    - 2 OECD Accession countries, and
    - the remaining G20 countries

The OECD issued a report, "Addressing Base Erosion and Profit Shifting," in February 2013, and an "Action Plan on Base Erosion and Profit Shifting" in July 2013.

Introduction

Government and OECD steps to address BEPS

November 2012 – G20 leaders met

Feb 2013 – OECD released "Addressing Base Erosion and Profit Shifting"

May 2013 – European Council meeting; Forum of Tax Administration meeting

June 2013 – G8 Summit; OECD's Committee on Fiscal Affairs to agree action plan

July 2013 – OECD's Action Plan delivered to G20 Finance Ministers

September 2014 – G20 leaders met Cairns, Australia

September 2015

December 2015

Action Items

September 2014

- Digital economy
- Hybrid mismatches
- Treaty abuse
- Transfer pricing documentation
- Transfer pricing of intangibles (1)
- Preferential tax regimes

September 2015

- CFC rules
- Permanent establishments
- Transfer pricing of intangibles (2), risks and capital, other
- Disclosure of aggressive tax planning
- Dispute resolution
- Data collection and analysis measuring BEPS

December 2015

- Interest deductions
- Harmful tax practices
- Multilateral instrument to address BEPS

BEPS Action Papers September 2014

OECD/G20 BEPS project

	Working Party 1 Tax Treaties	Working Party 6 Taxation of MNES	Working Party 11 Aggressive Tax Planning
Sept 2014	**Action 2 –** Neutralising hybrids **Action 6 –** Prevent treaty abuse	**Action 13 –** Transfer pricing documentation and country by country reporting to tax authorities **Action 8 –** Transfer pricing of intangibles (1)	**Action 2 –** Neutralising hybrids **Action 5 –** Counter harmful tax practices
Sept 2015	**Action 7 –** Prevent permanent establishment avoidance **Action 14 –** Dispute resolution	**Action 8 –** Transfer pricing of intangibles (2) **Action 9 –** Risk and capital **Action 10 –** Transfer pricing – high risk transactions	**Action 3 –** Strengthen CFC rules **Action 12 –** Disclosure (aggressive tax planning) **Action 4 –** Limit interest deductions
Dec 2015		**Action 4 –** Transfer pricing guidelines on financial transactions	

Action 1 – Digital economy (Digital Task Force)
Action 11 – Data collection / analysis (Working Party 2)
Action 15 - Multilateral instrument

Seven papers issued 16 September

Quick review of critical matters

Action 1:
Digital Economy

- No separate digital economy
- Other work streams to provide solutions?

Action 2:
Hybrids

- Paper stresses that double non-taxation is unacceptable in principle
- Detailed guidance to enact laws scheduled by September 2015
- 25% control threshold
- Requires (1) a hybrid and (2) either DNI or DD

Action 5:
Harmful tax practices

- Exchange of information between tax authorities – rulings & TP
- Need for substantial activities for "preferential" regimes –Nexus gaining ground

Action 6:
Treaty abuse

- Consensus in principle, not in detail (LOB v Purpose)
- Detail paper to follow 2015

Seven papers issued 16 September

Quick review of critical matters

Action 8:
Transfer pricing intangibles

- Very similar in context to July 2013 paper
- Section B held – adoption of guidance delayed until 2015
- Could cause a significant change in TP outcomes
- Emphasis on functions performed, assets used and risks incurred

Action 13:
TP documentation / CbC reporting

- C by C limited items / No agreement on practicalities – further delay
- Masterfile / local file
- Risk of increased burden

Action 15:
Multilateral instrument

- Paper outlining how to achieve multilateral agreement

Impact of BEPS actions on the Funds Industry

Introduction

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- Multilateral instrument

Action 13

Transfer Pricing Documentation

Country-by-Country Template

Master File

Local File

Information required by tax jurisdiction (aggregate for all entities including PEs)

- Revenues (related, unrelated, total)
- Profit/loss before income tax
- Income tax paid (cash)
- Income tax accrued
- Stated capital
- Accumulated earnings
- Number of employees
- Tangible assets (excl. cash/cash equivalents)

Impact of BEPS

Action 2 - Neutralising the Effects of Hybrid Mismatch Arrangements

- A hybrid mismatch arrangement is

  an arrangement that exploits a difference in the tax treatment of an entity or instrument under the laws of two or more jurisdictions to produce a mismatch in tax outcomes where that mismatch has the effect of lowering the aggregate tax burden of the parties to the arrangement

- Two types of perceived harmful outcomes

Double Deduction (DD)

Generates Double Deductions

Deduction/No Inclusion (D/NI)

Deduction on one side
No income taxed on the other side

Impact of BEPS
Summary of Targeted Hybrid Mismatch Arrangements

Deduction/ No Inclusion (D/NI) Outcomes	
Hybrid Financial Instruments	Deductible payment is not treated as taxable by recipient
Payments by Hybrid Entity	Hybrid payer has a deductible payment that is disregarded in the other jurisdiction
Payments to Reverse Hybrid	Payment to a reverse hybrid is not taxable due to hybrid effect
Double Deduction (D/D) Outcomes	
Payments by Hybrid Entity	A second deduction is taken in parent jurisdiction
Deductible Payments made by dual residents	Dual resident takes a deduction in two jurisdictions
Indirect Deduction/ No Inclusion (Indirect D/NI) Outcomes	
Imported Mismatch Arrangements	A hybrid mismatch is shifted (or imported) into another jurisdiction through the use of a plain-vanilla financial instrument

Impact of BEPS

How will Action 2 be implemented – “Linking Rules”

- It is proposed that linking rules will be introduced in jurisdictions that do not have anti-hybrid domestic rules.

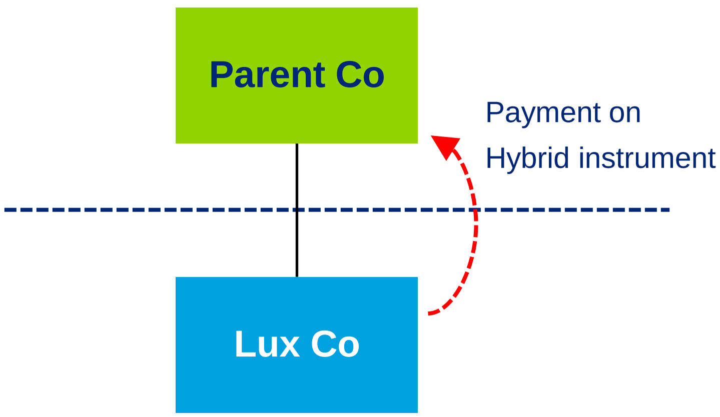
Response	Recommended Linking Rule
Primary	To deny a deduction where a mismatch arises
Defensive	To include the income as taxable income (To apply in cases where a primary rule does not operate, i.e. the recipient should be subject to tax if the payer takes a tax deduction)

- The intention is to avoid relying on another jurisdiction.
- A new model treaty provision is also recommended to address mismatches arising in respect of fiscally transparent entities (to expand application beyond partnerships)

Impact of BEPS

Examples of Hybrid Mismatch Arrangements

Hybrid Financial Instrument



Facts

- Parent Co holds shares in Lux Co as well as a hybrid instrument e.g. Convertible Preferred Equity Certificate (“CPEC”), Profit Participating Loan (“PPL”), or others

General tax consequences

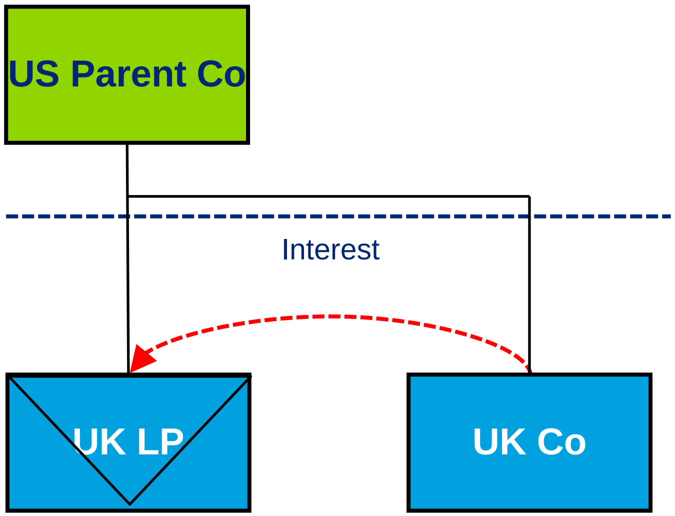
- Deduction in Lux Co for accrued interest expense under the hybrid instrument
- No taxation in Parent Co on income due to treatment of hybrid instrument as equity

Recommended hybrid mismatch rule		
Response	**Defensive rule**	**Scope**
Deny Lux Co a deduction	Parent Co includes as ordinary income	Related parties (25%) and structured arrangements (designed mismatch)

Impact of BEPS

Examples of Hybrid Mismatch Arrangements

Reverse Hybrid Entity



Facts

- UK LP is a partnership for UK purposes, but is checked to be a corporation for US purposes, i.e. a reverse hybrid
- UK Co makes an interest payment to UK LP

General tax consequences

- Interest deduction in UK Co
- UK LP is transparent for UK tax purposes, so no UK tax
- UK LP is treated as a corporate for US tax purposes so no immediate US taxation (unless includable pursuant to Subpart F)

Recommended hybrid mismatch rule		
Response	**Defensive rule**	**Scope**
Deny UK Co a deduction	None	Controlled group (50%) and structured arrangements (designed mismatch)
Recommendation to update offshore fund regimes to address imported mismatches, as well as limiting tax transparency for Revenue hybrids (i.e. treat hybrid entity as resident in location of establishment).		

Impact of BEPS

Example of Hybrid mismatch arrangements

Hybrid Transfers

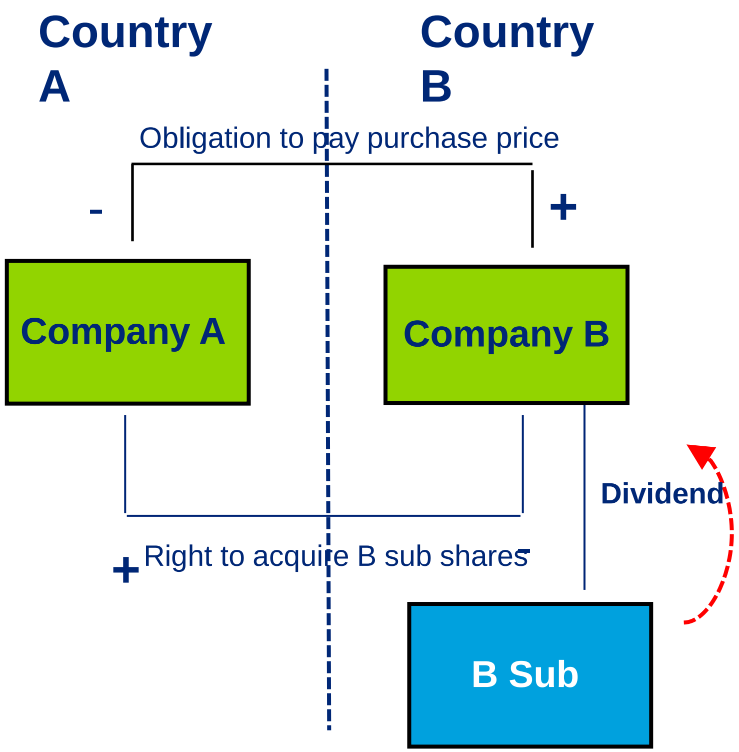
Characteristics:

- Collateralised loan arrangement or derivative transaction
- Both counterparties in different jurisdictions treat themselves as the "owner"
- Produces a mismatch in tax outcomes

Repo example:

- ➢ 1st party treats it as a sale and repurchase of the asset
- ➢ 2nd party treats it as a loan with asset being the collateral

Repo mismatch



Facts

- Co A sells shares of B Sub to Co B under an arrangement that A will acquire the B Sub shares at a future date for an agreed price (repo)
- Between date of sale and repurchase, B sub pays dividends to Co B.
- Net cost to A treated as deductible finance cost (including B sub dividend cost)
- Country B grants credit/exclusion/exemption to Co B on dividends received
- Co B treats transfer of shares to Co A as real sale - > possible participation exemption on gain

General Tax Consequences

- Deduction in Co A for repo payments
- No tax for Co B
- Mismatch

Recommended hybrid mismatch rule		
Response	**Defensive rule**	**Scope**
Deny deduction in Co A for payment	Include amounts as taxable ordinary income in Co B	Financial instrument held by a related party or as part of a structured arrangement. Some exceptions.
Restrict tax credit in Country B to net taxable income		No limit

Impact of BEPS

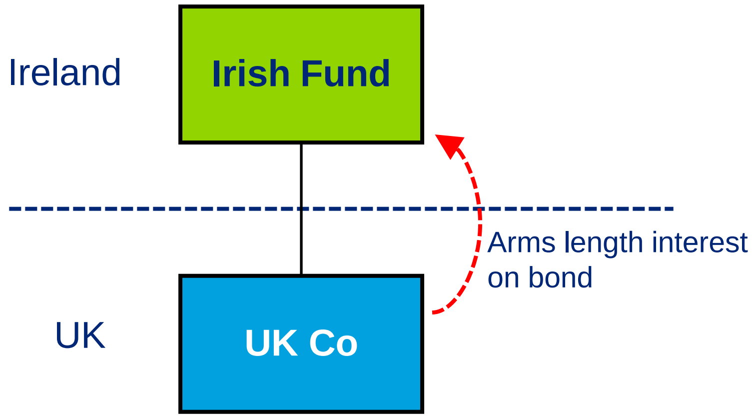
Hybrid Transfers

- Recognised that funds need further guidance and consideration

- Recommends an exception to allow a deduction for the payment, which may be difficult to achieve.

Impact of BEPS

Is this transaction caught by Action 2



Facts

- Fund holds bonds issued by a UK company

General tax consequences

- Interest is not taxable in Irish Fund, as all fund investors not Irish
- UK Co is entitled to deduction for interest under domestic UK rules

OECD BEPS impact

- Action 2 primary applicable? Is mismatch due to conflict in treatment of either instrument itself? Or in treatment of relevant entities?
- Should be considered further in context of Action 4 (Interest Deductibility) in 2015

Action 2

Proposed treaty provision on transparent entities

- Ensure income of transparent entities is in line with Partnership report.
- Grant tax treaty benefits in appropriate cases, ideally treaty benefits at investment and investor location and not fund location

Impact of BEPS

Action 2 – What does it seek to achieve?

To neutralise tax mismatches

- To focus on arrangements that exploit differences in the way cross-border payments are treated for tax purposes in the jurisdiction of the payer and payee – and only to the extent such difference in treatment results in a mismatch. Must have a hybrid element.
- Action 2 sets forth recommendations to combat erosion of the aggregate worldwide tax base by providing recommendations for:
  - Domestic rules
  - Changes to the OECD Model Tax Convention & Treaties

Some important exceptions

- Action 2 focuses on hybrid mismatch arrangements of most concern to jurisdictions, not all types of mismatches. Only those relying on hybrid element; e.g. where same entity is treated differently in two jurisdictions or where there is conflict in treatment of the same financial instrument.
- Does not extend to deemed deductions, NOL utilisation etc.
- Does not extend to tax exempt entity where there is no hybrid aspect.

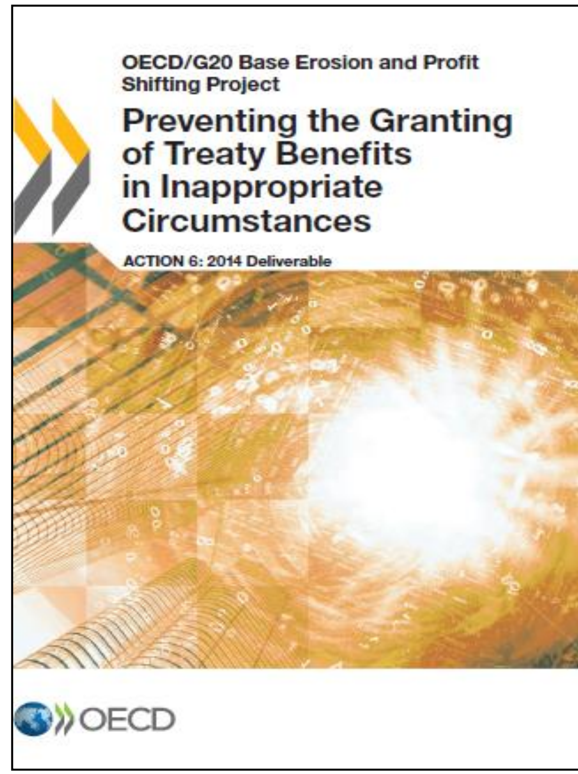
Impact of BEPS

Action 2 and Funds

Tax exempt structures	• In some locations funds may not actually pay tax. Risk that some countries may consider them tax exempt, which is not the case. ➢ not a hybrid entity under BEPS.
Efficient Portfolio Management (EPM) by funds using repos, securities lending.	➢ Not a hybrid instrument purely because utilised by a fund where receipt/payment is not taxable/deductible. ➢ Further guidance and consideration needed.
Transparent Structures e.g. FGR, FCP, CCF	➢ Not a hybrid entity in many cases. ➢ Opportunity for recognition of transparency across OECD. ➢ Reverse hybrids – limit transparency to treat hybrid entity as resident in location of establishment. ➢ Offshore fund regimes may need updating to address imported mismatches

Impact of BEPS

Action 6 – Prevent Treaty Abuse



Focus of Action 6

Prevent Treaty Abuse

1. Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of Treaty benefits in inappropriate circumstances.

2. Clarify that tax treaties are not intended to generate double non-taxation

3. Identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country

Treaty Access is fundamentally important to Funds

Why?

- **1.** Avoids double taxation of Fund Investors.
- **2.** Enhances fund performance.

Issues/challenges for funds

- Limitation on Benefits Provisions.
- Multilateral Agreement (Action 15)
- GAAR (General Anti-Avoidance Rules)/PPT (Principal Purposes Test)
- Practical operation and application of treaty benefits e.g. nominees, regular change in ownership of the fund units.

Other BEPS items will impact on Action 6

For example:

A

- Action 5 – counter harmful tax practices
- Action 8 – intangibles

➢ Derivative benefits provisions and USA considerations in Action 5 & 8 will affect wording of proposed LOB in Action 6

B

- Domestic Anti Avoidance Rules in Action 6 likely to be impacted by Actions 2,3,4,8,9 & 10.

Impact of BEPS

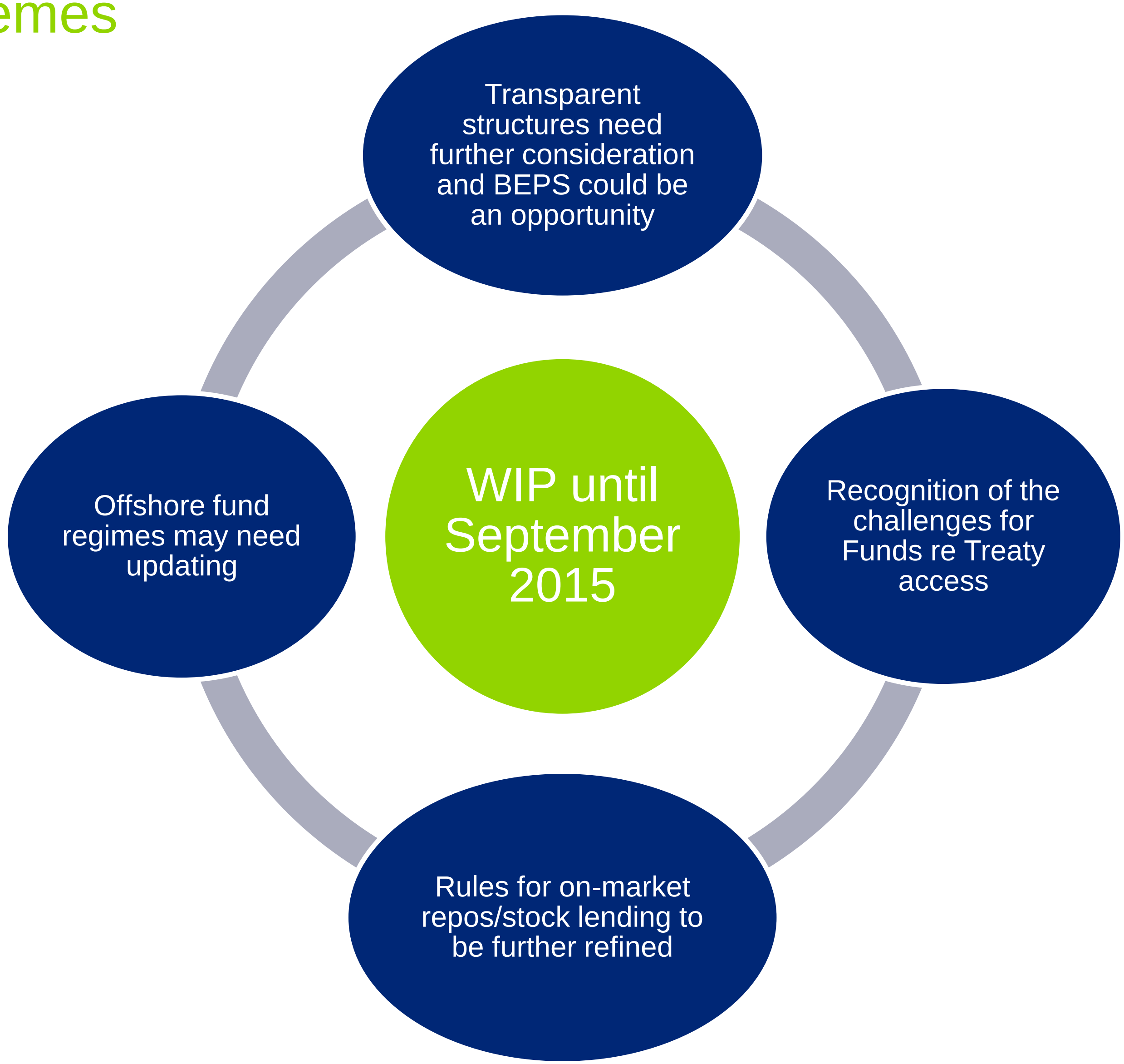
"Further work is also needed with respect to the implementation of the minimum standard and with respect to the policy considerations relevant to treaty entitlement of Collective Investment vehicles (CIV's) and non-CIV funds"

"The model provisions and related commentary……… of this report should therefore be considered as drafts that are subject to improvement before their final versions are released in September 2015"

Conclusion

Outcome of September 2014 Deliverables from a Funds Perspective

Key Themes



OECD calendar for planned stakeholders' input

OECD

OECD/G20 BEPS Project: Calendar for planned stakeholders' input

Version: 2 October 2014 *(Update: Action 3 public consultation date)*

BEPS Action Plan Item		Type	Date*	Deadline
8-10	Low-value adding services	Discussion Draft	Mid October 2014	45 days after release
7	PE Status	Discussion Draft	End October 2014	60 days after release
6	Treaty Abuse	Discussion Draft	Mid November 2014	45 days after release
Update on progress		Webcast	November 2014	
1	VAT B2C Guidelines	Discussion Draft	Early December 2014	Mid February 2015
4	Interest Deductions	Discussion Draft	Mid December 2014	30 days after release
8-10	Risk, recharacterisation	Discussion Draft		
8-10	Commodity transactions	Discussion Draft	Mid December 2014	45 days after release
8-10	Profit splits	Discussion Draft		
14	Dispute Resolution	Discussion Draft	December 2014	30 days after release
7	PE Status	Public Consultation	21 January 2015	
6	Treaty Abuse	Public Consultation	22 January 2015	
14	Dispute Resolution	Public Consultation	23 January 2015	
Update on progress		Webcast	January 2015	
11	Economic Analysis	Discussion Draft	Late January 2015	30 days after release
4	Interest Deductions	Public Consultation	17 February 2015	
1	VAT B2C Guidelines	Public Consultation	19 or 20 February 2015 (tbc)	
8-10	Risk, recharacterisation			
8-10	Base eroding payments (including commodity transactions and low value adding services)	Public Consultation	19-20 March 2015	
8-10	Profit splits			
11	Data Analysis	Public Consultation	27 March 2015	
12	Disclosure Rules	Discussion Draft	Late March 2015	30 days after release
3	CFC Rules	Discussion Draft	Early April 2015	30 days after release
8-10	CCAs	Discussion Draft	Early April 2015	30 days after release
8-10	Intangibles – ownership; hard to value	Discussion Draft	Early April 2015	30 days after release
Update on progress		Webcast	April 2015	
12	Disclosure Rules	Public Consultation	11 May 2015	
3	CFC rules	Public Consultation	12 May 2015	
8-10	CCAs	Public Consultation	July 2015	
8-10	Intangibles – ownership; hard to value			

» View the complete calendar online: www.oecd.org/ctp/discussiondrafts.htm
» Information about OECD work on BEPS: www.oecd.org/tax/beps.htm

* *All dates are subject to change*

Legend

Request for input — Discussion Draft — Public Consultation — Webcast

What we would like to see in September 2015 papers

Action 6 – Treaties	• Ideally carve out for funds in any LOB wording in a treaty • If not a complete carve out, then suitable derivative benefits provision to facilitate funds accessing treaties • GAAR/PPT rule should provide certainty for funds given 2010 OECD report
Action 2 – Hybrids	• Ensuring funds are not disadvantaged by EPM - repo/stock lending • Greater recognition within OECD/G20 for tax transparent fund structures
Action 15 – Multilateral Agreement	• Suitable incorporation of funds into the multilateral agreement