Investment Management Tax Update

Link and Learn

01 October 2015

Agenda

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Objectives of today's Link and Learn

- FATCA – Latest Developments
- OECD Common Reporting Standard – New Exchange of Information Provisions
- Capital Gains – Tax Provisioning, Risks, Monitoring Jurisdictional Rule Changes….
- Transfer Pricing - Implications for Management Companies
- VAT – Case Law Developments
- BEPS – Latest on Proposals

FATCA

Latest Developments

FATCA

Latest Developments

- Most FATCA returns filed have been nil returns
- Revenue FATCA compliance programme
- Nil FATCA reporting FY16 – tick the box approach

OECD Common Reporting Standard (CRS)

New Exchange of Information Provisions

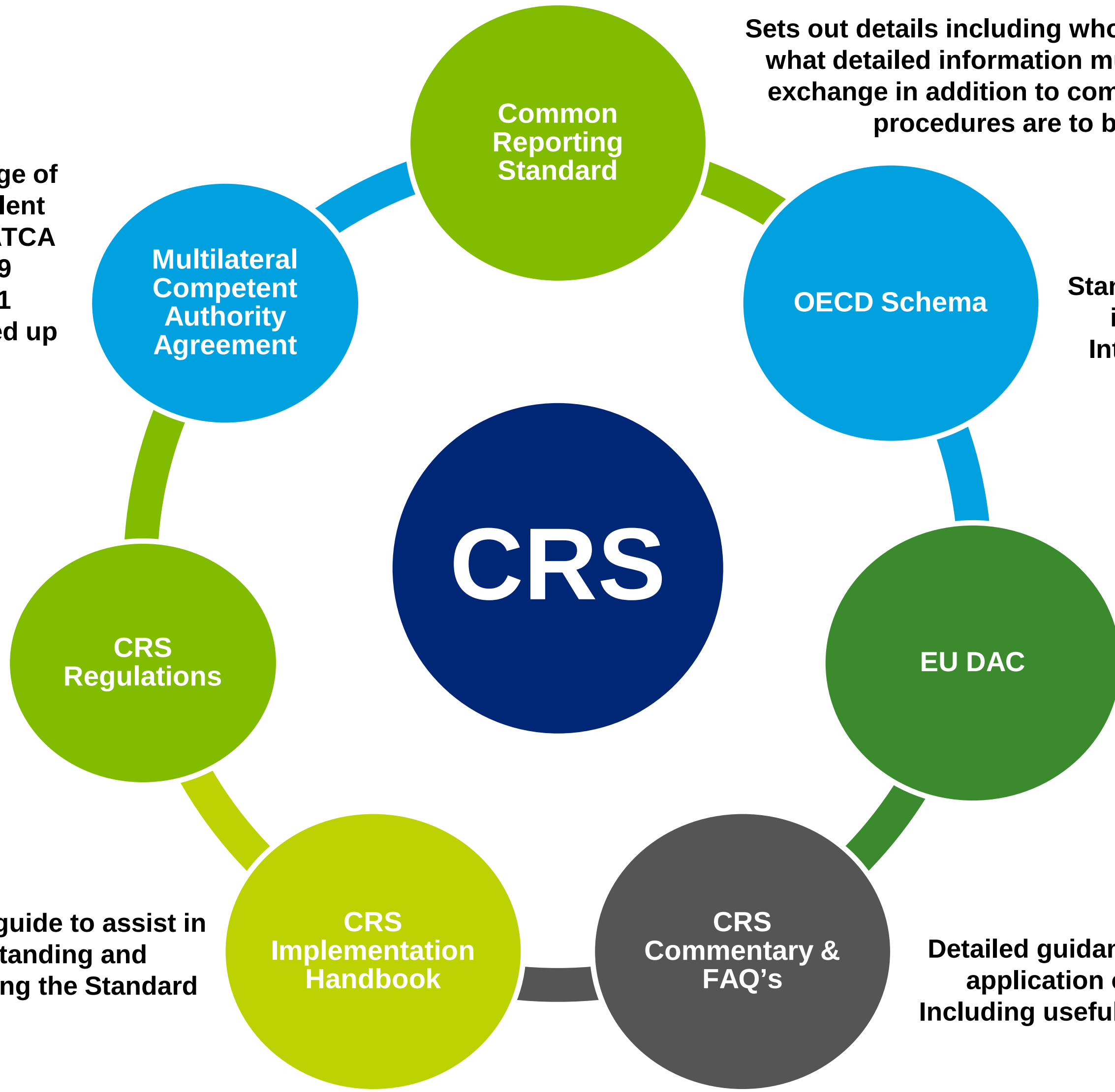
OECD Common Reporting Standard

What is CRS?

- A new, single global standard on automatic exchange of information which is aimed at addressing perceived offshore tax evasion.
- Developed and approved by the OECD in February 2014, CRS aims to maximise efficiency and reduce costs for financial institutions by drawing heavily on the approach taken to implementing FATCA.
- Obligates all **Reporting Financial Institutions** (as defined in the standard) to carry out the due diligence processes for identifying Reportable Accounts of non resident persons & exchanging it with those persons countries of tax residence. **Non Reporting Financial Institutions** have no such obligation but must be clear as to their CRS classification for reporting to other Reporting Financial Institutions.
- Over 90 jurisdictions have committed to exchanging information under CRS and a group of over 60 countries, including Ireland, have committed to the early adoption of CRS.
- Irish legislation is expected to be effective from 1 January 2016 with the first data exchanges taking place in September 2017.

OECD Common Reporting Standard

What information has been released?



Common Reporting Standard: Sets out details including who needs to report and what detailed information must be collected for exchange in addition to common due diligence procedures are to be followed

OECD Schema: Standard for transmitting info electronically. Intended to overcome practical issues

EU DAC: Council Directive amending EU laws to allow for CRS implementation in EU Member States

CRS Commentary & FAQ's: Detailed guidance on the application of CRS Including useful examples

CRS Implementation Handbook: A practical guide to assist in understanding and implementing the Standard

CRS Regulations: Still in draft form. Period for initial commentary is now closed

Multilateral Competent Authority Agreement: Rules on the exchange of information. Equivalent to main body of a FATCA IGA. Signed on 29 October 2014 – 61 Member States signed up

OECD Common Reporting Standard

CRS Classifications

- **Financial Institution**
  - ➢ Custodial Institution
  - ➢ Depository Institution
  - ➢ Investment Entity *****
  - ➢ Specified Insurance Company *****

  ** Specific definitions under FATCA & CRS slightly differ*

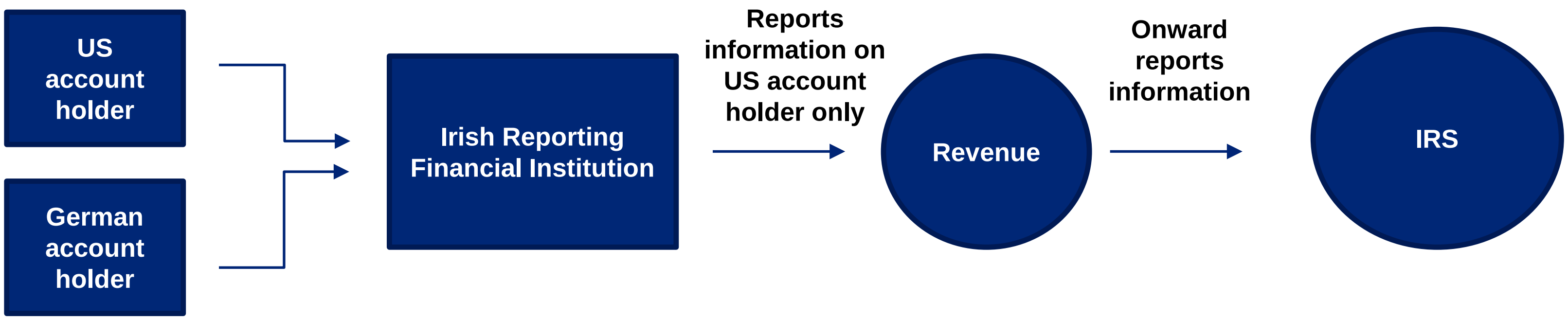
- **Reporting Financial Institution**
  - ➢ A Financial Institution which is not a Non Reporting Financial Institution

- **Non Reporting Financial Institution**
  - ➢ Government Entities, Central Bank, Certain Retirement Funds

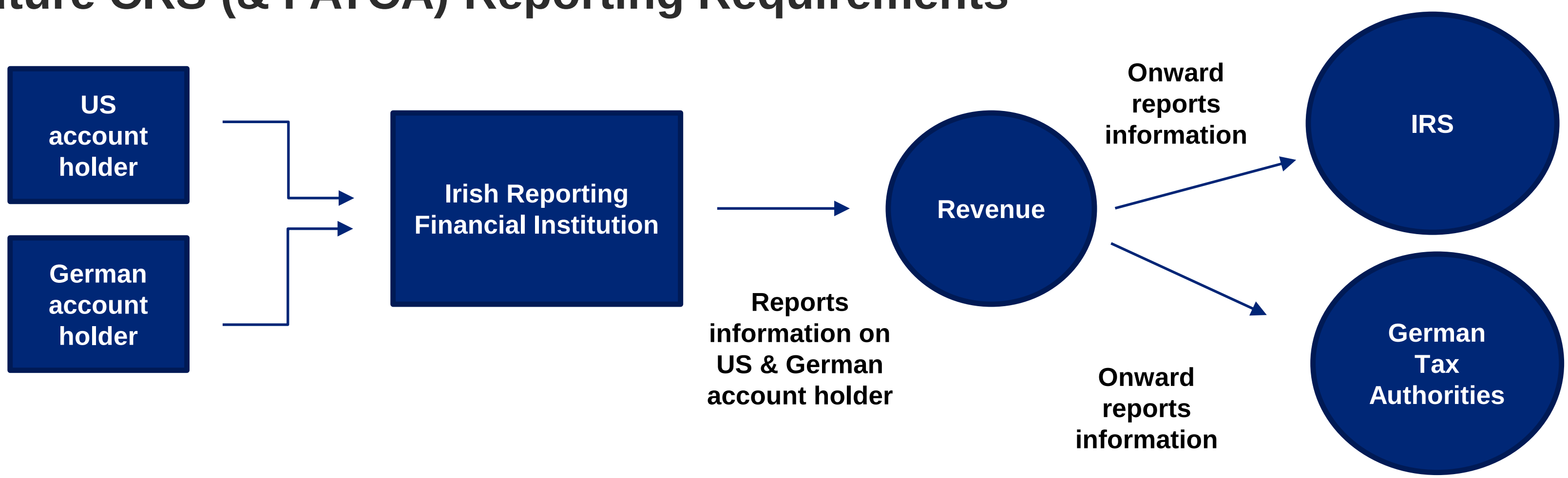
OECD Common Reporting Standard

Increased Reporting on a Greater Number of Account Holders

Current FATCA Reporting Requirements



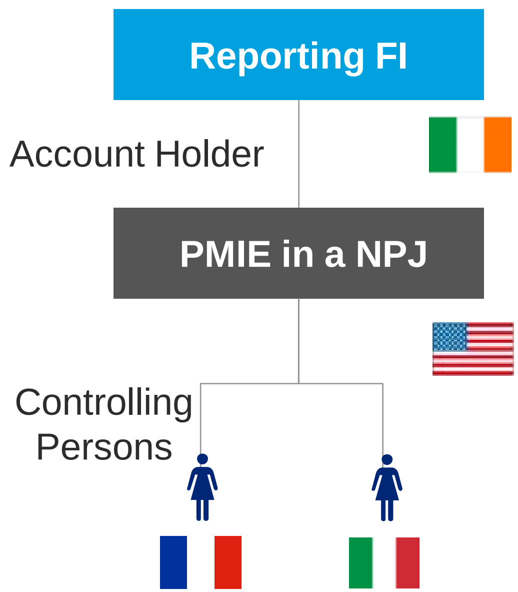
Future CRS (& FATCA) Reporting Requirements



OECD Common Reporting Standard

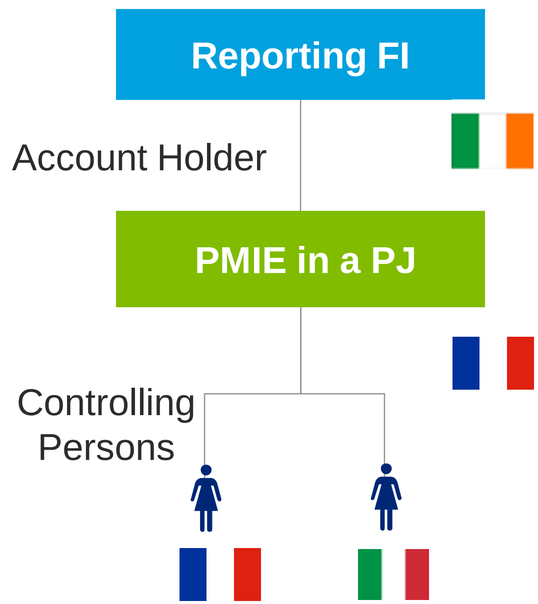
Professionally-Managed Investment Entities ("PMIE's") in Non-Participating jurisdictions treated as Passive NFFEs

PMIE in Non-Participating Jurisdictions



- Account holder is a PMIE in a NPJ as no Ireland-US CRS agreement
- PMIE treated as a Passive NFE
- Controlling Persons in Reportable Jurisdictions are reported

PMIE in Participating Jurisdictions



- Account holder is a PMIE in a Participating Jurisdiction
- PMIE treated as a FI
- Controlling Persons not reportable as no requirement for the French FI to look through

OECD Common Reporting Standard

Other Key Differences between CRS & FATCA

- There is no withholding tax obligation where CRS rules are not complied with which was not the case for FATCA
- Identifying which accounts holders are reportable under CRS is a residence based test as opposed to a citizenship based test as was the case for FATCA
- Certain categories of Non Reporting Financial Institutions have also been removed from CRS meaning a greater number of entities will have CRS registration and reporting requirements
- The exemption for Listed Regularly traded Financial Accounts which existed for FATCA, has not been included under CRS
- The thresholds for reporting pre-existing individual and entity accounts have either been lowered or completely removed
- Format of self certification for CRS

OECD Common Reporting Standard

Next Steps

Identify your entity classification for CRS purposes to determine if you have an obligation to report. If so;

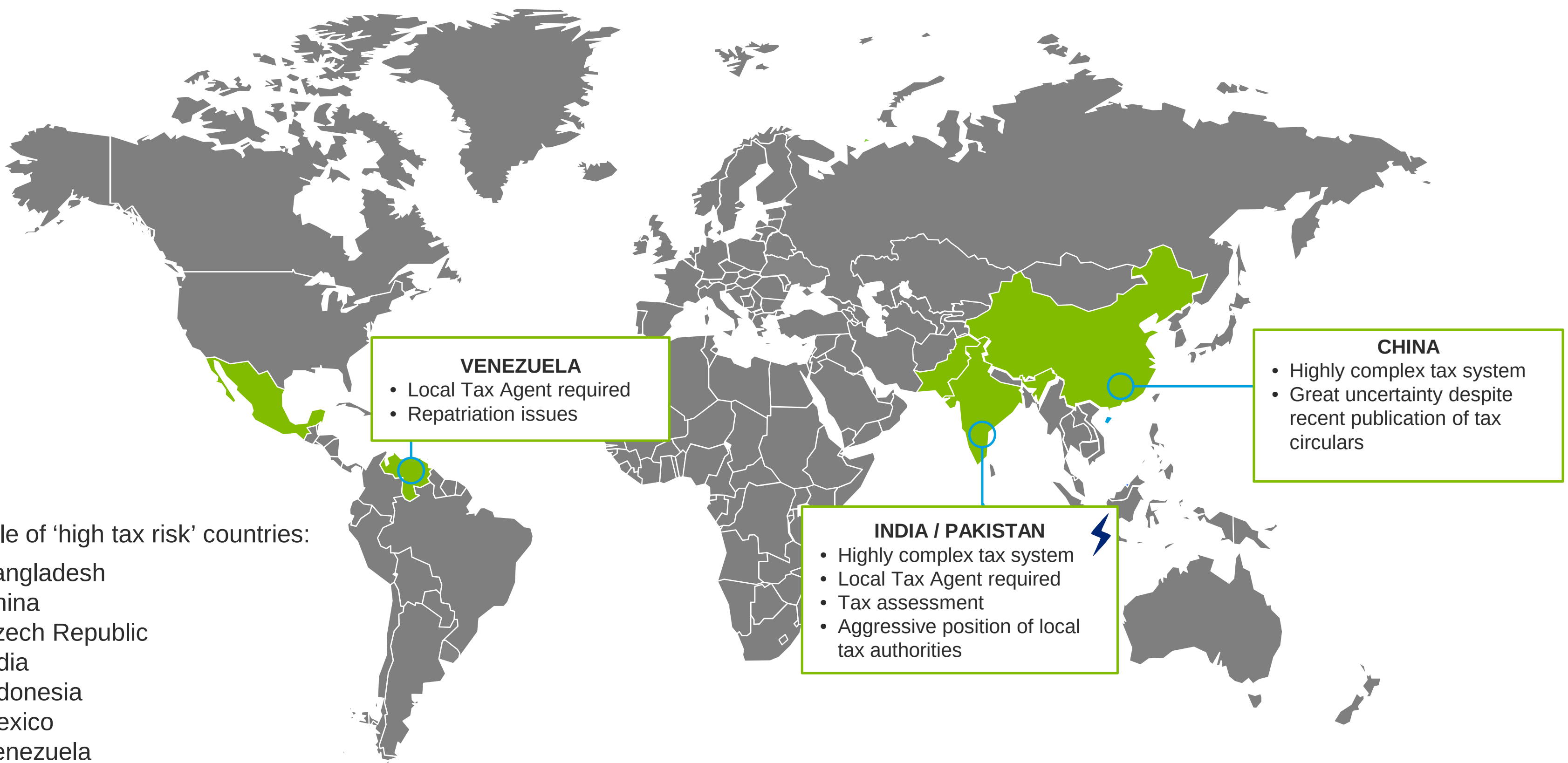
- Establish project teams and resources for impact assessment & the collection of data for reporting – identify outside service providers as required
- Establish CRS governance and develop strategic plan
- Identify in scope Financial Accounts
- Confirm compliant account holder due diligence approach including form of self certification
- Consider how to track implementation across multiple jurisdictions & changes
- Assess impact of potential changes required to internal policies and procedures

Capital Gains

Tax Provisioning, Risks, Monitoring Jurisdictional Rule Changes

Capital Gains

World map of high risk countries



Example of ‘high tax risk’ countries:

- Bangladesh
- China
- Czech Republic
- India
- Indonesia
- Mexico
- Venezuela
- Pakistan
- etc.

Capital Gains

High risk jurisdiction: China

A-shares

- As from 17 November 2014, capital gains realized on the sale of A-shares by QFII/RQFII or on the Stock Connect, should be exempt from Chinese capital gains taxation.
- Before 17 November 2014, capital gains realized by QFII/RQFII should be subject to Chinese taxation (10%).

B-shares

- Lack of clear certainty to whether capital gains realized on the sale of B-shares will be subject to Chinese taxation.

H-shares

- Lack of clear certainty to whether capital gains realized on the sale of H-shares will be subject to Chinese taxation

Operational Tax News
China Update

QFII/RQFII - clarifications provided by the Beijing Tax Authorities

As mentioned in our tax alert issued on 19 November 2014, starting from 17 November 2014, any China-sourced gain on the transfer of equity investments derived by Qualified Foreign Institutional Investors ("QFII") and Renminbi Qualified Foreign Institutional Investors ("RQFII") will be temporarily exempt from People's Republic of China Enterprise Income Tax. Any gains realised by QFIIs/RQFIIs prior to 17 November 2014 will remain subject to taxation.

Impact Areas

Tax basis for A-shares (weighted average cost vs FIFO)	Tax basis for B-shares (weighted average cost vs FIFO)	Tax basis for H-shares (weighted average cost vs FIFO)	Gross basis vs. Net basis	Retroactive time frame	Interest on late payments	Treaty Relief
Competent authority to receive the CGT	Duration of the tax exemption	Deduction of losses	Offsetting gains vs losses	Application of penalties	Mechanism for settling the tax liability	

- The 2014-2015 tax changes in China have shown the unpredictability of tax changes and have also exposed considerable tax liabilities, some that may have an impact on the fund's accounts.
- Foreign funds investing in China in the previous years are now, potentially, exposed to Chinese taxation.

Capital Gains

High risk jurisdiction: India

Dividends

- Exempt from India WHT

Interest

- Corporate and Government Bonds – from 5,15% to 5,665% WHT (varies depending on whether the FPI is a corporate or a non corporate entity)

Cap Gains
Listed Sec

- Short term gains: from 15,45% WHT to 16,995% WHT (varies depending on whether the FPI is a corporate or a non corporate entity)
- Long term gains: exempt

Minimum Alternate Tax (MAT)

On 1 September 2015 the Indian Government accepted the report of the A. P. Shah Committee which had recommended that the Minimum Alternate Tax (MAT) should not be applicable to Foreign Institutional Investors (FIIs) or Foreign Portfolio Investors (FPIs) even for the period before 1 April 2015.

The A. P. Shah Committee submitted its final report on 25 August 2015 and three days ago, at a press conference, the Finance Minister has confirmed that the Indian Government has accepted its recommendations.

This is good news for Luxembourg and Irish corporate type FIIs/FPIs (i.e. SICAVs/VCC) who have received tax assessments for settlement of the MAT. This decision and public announcement from the Indian Finance Minister confirms that corporate type funds will not be subject to the MAT in respect of the period before 1 April 2015.

Contractual type funds (i.e. FCPs/Trusts) were never in scope of the MAT due to the fact that the MAT only applied to corporate entities.

It is anticipated that the acceptance by the Government will be formalized shortly by the issuance of a circular and an amendment to the law to clarify the non-applicability of the MAT to FIIs/FPIs.

Operational Tax News
Minimum Alternate Tax ("MAT") Update

The Indian Minimum Alternate Tax (MAT) has been one of the tax hot topics over the recent months. The change of position of the Indian tax authorities on what concerns the application of the tax to foreign investors is causing much controversy and debate. Please click below for our alert outlining MAT.

Capital Gains

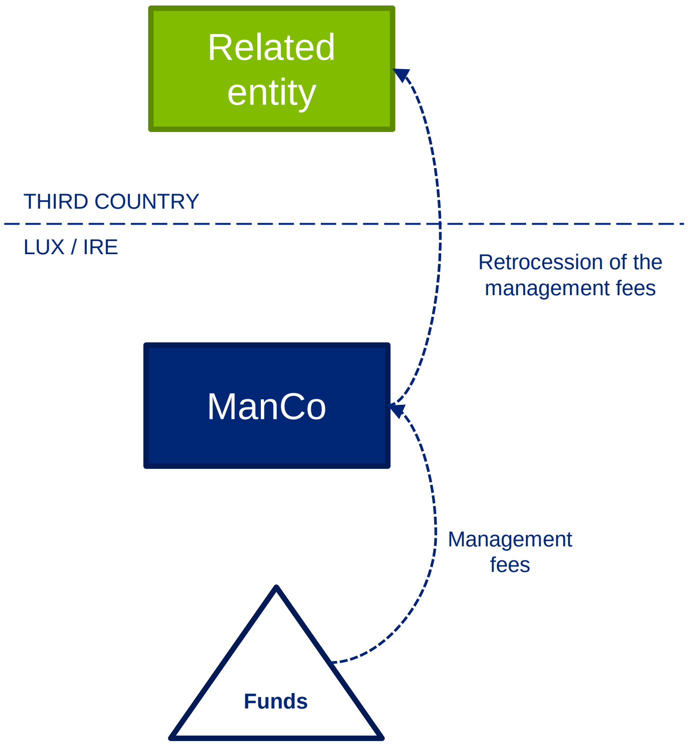
Current trends and services

	Description
AWARENESS OF LOCAL CAPITAL GAINS TAX RISK	• Management Companies are increasing their awareness of the risk for funds to be taxed on capital gains in the countries of investment • Notwithstanding the above, the majority of Management companies do not monitor systematically the local taxation (and eventual changes) in the countries of investment and the risk exposure of their funds
PROVISION FOR UNREALIZED CAPITAL GAINS	• Funds investing in high risk countries book provisions for unrealized capital gains only occasionally • The computation of the provision to be booked usually requires specific local expertise
DELOITTE'S ASSISTANCE	• We assist funds in assessing the high risk countries providing them with a sanity check review, where we: ✓ Review the countries of investments to identify in which high risk countries the fund is investing (if any) ✓ Check the compliance of the fund with the local tax requirements on capital gain taxation ✓ Coordinate with our local offices to ensure the local tax compliance of the fund

Transfer Pricing

Implications for Management Companies

Transfer Pricing
Implications for Management Companies



Transfer Pricing for Management Companies - Background

- ✓ Management Companies (**ManCo**) can delegate some functions to third or related parties
- ✓ Remuneration for the performance of the delegated functions is usually represented by the retrocession of a portion of management fees
- ✓ In the case that functions are delegated to a related entity, the remuneration recognized by the ManCo has to comply with the ***"arm's length principle"***

Transfer Pricing for Management Companies - Analysis

- ✓ Both Luxembourg and Ireland are OECD countries and, therefore the main reference on transfer pricing analysis are OECD Transfer Pricing Guidelines for MNE (**Guidelines**)
- ✓ The Guidelines set out 5 main transfer pricing method that are applicable to document compliance of intercompany transactions with the arm's length principle
- ✓ The determination of an appropriate transfer pricing policy is based on the functional and risk profile of the entities involved (Paragraph 1.42 of the Guidelines)
- ✓ Therefore, in order to select the most appropriate transfer pricing method and to identify comparable transactions (if any), it is necessary to understand (i) the functions performed; (ii) the risks borne; and (iii) the assets used.

Transfer Pricing

Selection of the transfer pricing method

Transfer Pricing for Management Companies
Luxembourg experience

- ✓ The functional analysis on Luxembourg ManCo mainly involve:
  - ✓ Functions: which risks are delegated to the related entity
  - ✓ Risk: how risk are allocated among the ManCo, the related entity and the investors
  - ✓ Assets: in the IM industry assets are mainly represented by people
- ✓ In Luxembourg, the most selected transfer pricing method applied to ManCo is the contribution profit split method (PSM)
- ✓ The PSM is typically applied when the level of interrelation between transactions is high and can hardly be assessed separately. This method also applies when both parties to the transaction are jointly contributing to the core earning power of the group ("**both parties make a unique and valuable contribution**").
- ✓ According to the contribution PSM the profits arising from an intercompany transaction ("the combined profits") are split between the parties to the transactions based on the **relative value of their contribution**

Transfer Pricing for Management Companies
Irish experience

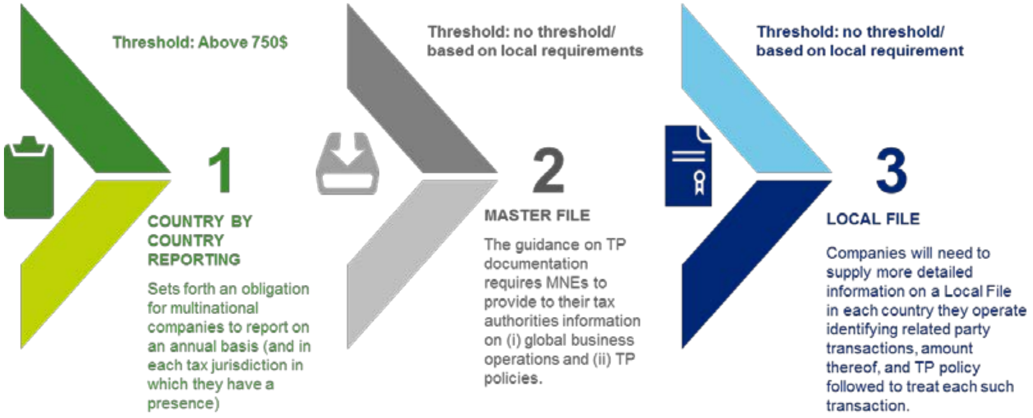
- ✓ The functional analysis of an Irish ManCo mainly involves:
  - ✓ Functions: which functions are delegated to the related entity
  - ✓ Risk: how risks are allocated between the ManCo, the related entities and the investors
  - ✓ Assets: in the IM industry assets are mainly represented by people
- ✓ With respect to Ireland, the selection of the appropriate TP method is very much dependent on the type and number of functions delegated to the ManCo, the risks assumed and the assets used (i.e. number of employees at disposal of the related entities).
- ✓ For example, if the ManCo is the named fund manager but delegates all functions (e.g. custody services) to other related entities it may be appropriate to only allocate a routine return to the Manco for bearing fiduciary risk. However, if the ManCo is responsible for some additional functions involving a number of employees another approach may be more appropriate (e.g. profit split where both parties are making a unique and valuable contribution).

Transfer Pricing
Future trends

Description

Country-by-Country report

- Action 13 of the BEPS project recommends the introduction of a Country-by-Country Report that would highlight data (i.e. the profit before tax and the amount of taxes) for each State in which the group operates
- The Country-by-Country Report would therefore increase the amount of information at disposal of the local Tax Authorities



Increasing focus by Tax Authorities

- Both in Luxembourg and in Ireland, the local Tax Authorities are increasing their expertise and their focus on transfer pricing issue
- In particular in Ireland, over the last year, the Irish Revenue increased their internal resources to deal with transfer pricing matters, with a number of experienced hires from practice in the areas of competent authority and audits. The first transfer pricing audits are now taking place in Ireland

VAT

Case Law Developments

VAT

Case Law Developments

VAT Exemption Applies to:

"The Management of Special Investment Funds as defined by Member States"

(As per Article 135.1 (g) of Council Directive 2006/112)

Two elements to the VAT Exemption:-

(a) The Services Provided Must Constitute '**Management**'

(a) The Recipient Entity Must Constitute a '**Special Investment Fund'**

<u>**We will consider these concepts in reverse order.**</u>

VAT

Case Law Developments Special Investment Funds

Banque Bruxelles Lambert S.A.(C-8/03)

Abbey National (C-169/04)

Deutsche Bank AG (C-44/11)

JP Morgan Fleming Claverhouse Investment Trust plc & Others (C-363/05)

Wheels Common Investment Fund Trustees Ltd & Others (C-424/11)

ATP PensionService (C-464/12)

Fiscale Eenheid X NV cs (C-595/13) (Opinion)

VAT

Case Law Developments - **Management**

Abbey National (C-169/04)

ATP PensionService (C-464/12)

GfBk Gesellschaft fur Borsenkommunikation mbH (C-275/11)

Fiscale Eenheid X NV cs (C-595/13) (Opinion)

BEPS

Latest on Proposals

BEPS

Action 6 – Preventing the Granting of Treaty Benefits

9 April 2014

22 May 2015

Discussion Documents

Deadline for comments consultation period

Release of discussion draft on follow-up work

Release of a revised discussion draft

Final BEPS package to be released

14 March 2014
Discussion draft released

21 November 2014

5 October 2015

- Final BEPS package to be released on 5 October 2015
- The redefinition of the Limitation of Benefits (“LOB”) could potentially impact the investment management industry but it will depend on how each country will apply BEPS 6 and liaise it with their domestic rules – which based on current comments will not be straightforward
- Compatibility with the EU Treaties and ECJ case laws ? (ECJ judgments in cross-border tax cases: tax planning is OK, up to some limits)

BEPS

Action 6 – Application of the LOB rule : Impact for CIVs

OECD PROPOSED APPROACH

Description

- **Definition of Collective Investment Vehicle (CIV) at OECD level:** Funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established
- In 2010, the OECD released a report dealing with the access to Double Tax Treaties for CIV (**the CIV Report***)
- The recommendations for CIV contained in Action 6 are aligned to the position expressed in the CIV Report:

- Inclusion of a provision dealing with the CIVs in the LOB rule
  - ✓ **If a treaty does not have a rule specifically addressing treaty residence of CIV**: it would be appropriate to require that CIVs be "qualifying persons" for LOB purposes by meeting different possible alternative tests
  - ✓ **If a treaty already has contains a "residence test" to grant the access to CIVs**: it would be not necessary to include a LOB addressing CIVs

DELOITTE'S COMMENTS

- Deloitte actively participated to public consultation on Action 6 discussion draft
- Deloitte suggested approach:
  - ✓ Amendment of the LOB rule in order to include CIVs as "qualified residents"
  - ✓ Consider CIVs as "residents" according to Article 1 as suggested by paragraph 6.17 of the commentaries to the OECD Model Convention and as suggested by the 2010 CIV Report

* «Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles»

BEPS

Action 6 – Impact for NON CIVs

Description

OECD PROPOSED APPROACH

- The report acknowledged that further work is required in respect of the policy considerations relating to non-CIV funds, such as REITs, sovereign wealth funds, pension funds and alternative funds (i.e. PE funds)
- Most of the issues identified relate to the LOB but conclusions have not been reached on the treatment of all non-CIV funds
- **Proposal on REITs**: it has been proposed that the commentary should refer to the 2008 "Tax Treaty Issues Related to REITs" report
- **Proposal on pension funds**: pension funds should be considered to be a resident of the state in which they are constituted, regardless of whether they benefit from a limited or a complete exemption from taxation in that state

DELOITTE'S COMMENTS

- Deloitte actively participated to public consultation on Action 6 discussion draft
- On what concerns access to treaty entitlement, Deloitte suggested that any of the preferred approaches would be to include non-CIVs, where there investor base is represented by, either:

✓ Investors which are already, by themselves, treaty entitled - such as pension funds -, or by
✓ Investors who do not hold the individual controlling power of the management decisions of the fund and are themselves subject to taxation in their countries of residence – such as is the case of widely held funds.

Conclusion

Finishing words

Conclusion

Wrap up

- Tax developments in many areas:

- Spotlight goes to FATCA & CRS, the BEPS initiatives and the continuous changes in local taxation rules which can impact the investment management industry

- We expect the end of this year to be flourishing with tax news and we anticipate that 2016 will bring more news