Lunch & Learn – Investment Funds

Transfer Pricing Dimension of Regulated Management Companies

July 14, 2021

On the radar for asset managers

Keeping track of business and regulatory developments - interaction with tax and transfer pricing dimensions

CSSF developments – on-site visits and Circular 20/744

Governance – robust TP documentation as best practice

Increased scrutiny by Tax authorities of transfer pricing models for local Asset Managers

Tax audit campaign in Luxembourg – development and trends

External statutory auditors in Luxembourg – increased focus on TP

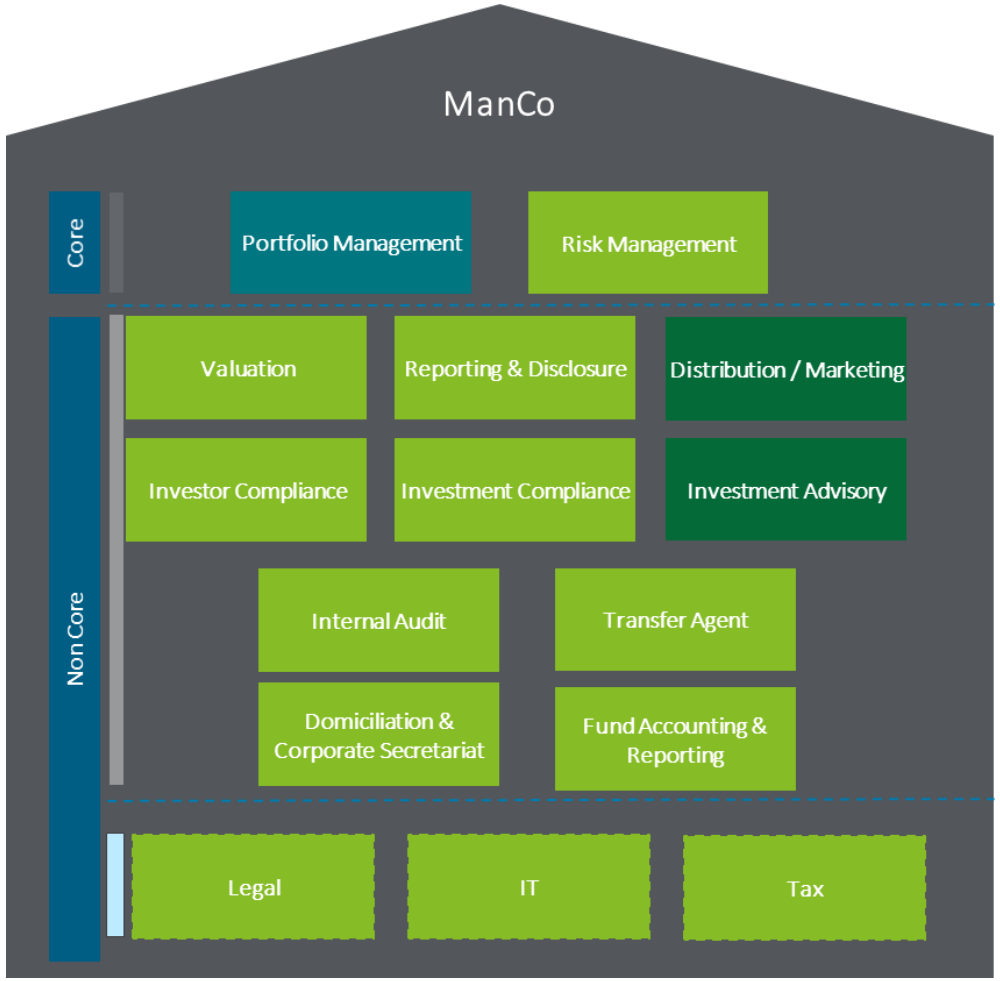
Brexit legacy and reorganization of business/ operating models

MiFID II – ban on inducements, increased compliance costs and extension of licenses

Impact of Covid-19 – potential loss situations and the future of work

Usual Transfer Pricing approaches for Asset Managers

1. CUP-based approach focuses on identifying service arrangements between funds and third party ManCo/AIFMs in order to benchmark the remuneration for the principal role
2. The benchmarking study is based on so-called third party management company service providers that offer their regulatory platform as well as functions with respect to risk management, compliance, reporting and oversight to unrelated parties.
3. Dedicated databases allow to observe all active funds and their respective ManCo/AIFMs, out of which independent ManCo/AIFMs operating under a similar delegation model are selected
4. Benchmarked ManCo/AIFM remuneration can be expressed (i) in basis points in relation to the Assets under Management as well as (ii) a percentage of the total management fees paid by the fund vehicles
5. Benchmark allows for adjustments to factor fund size / volume of AuM



Business reorganisations

Chapter IX of the OECD Guidelines is exclusively dedicated to Transfer Pricing aspects of business restructurings.

"Business restructuring refers to the cross-border reorganisation of the commercial or financial relations between associated enterprises, including the termination or substantial renegotiation of existing arrangements."

Chapter IX OECD Guidelines

Involve cross-border transfers of "something of value" (e.g., valuable intangibles, going concerns) or alternatively involve the termination or substantial renegotiation of existing arrangements

Changes in the internal processes and responsibilities: functions and risk profile of the parties before and after the restructuring need to be understood

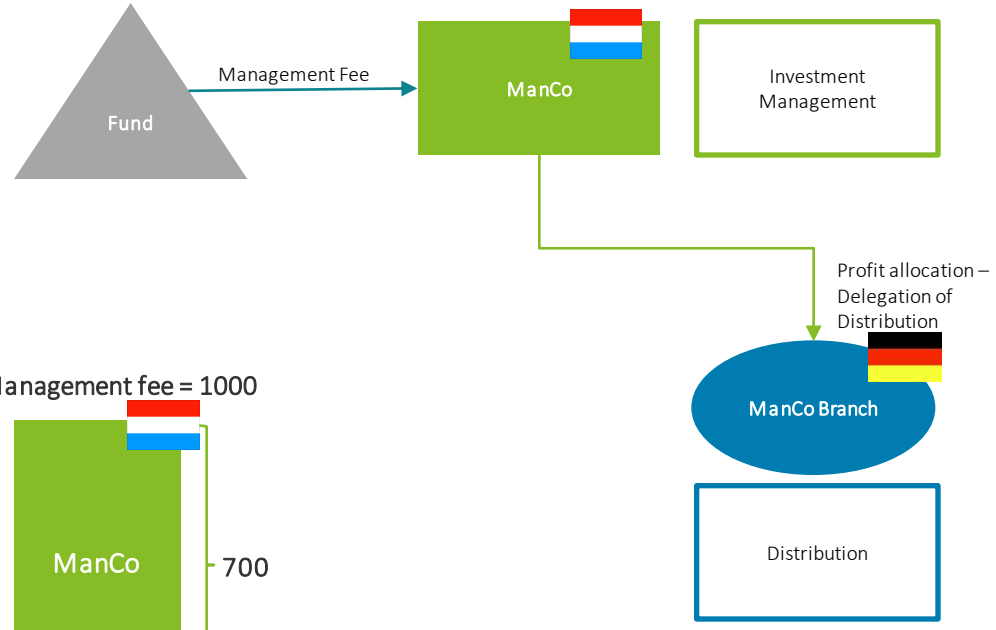
Value of assets/functions transferred needs to be determined - would such transfer be compensated by third parties under similar conditions?

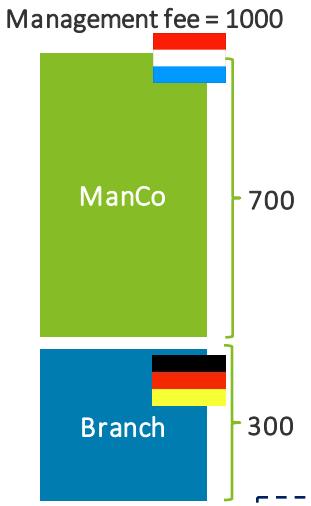
Cross-border shift of Investment Management and Distribution function between existing or newly incorporated Group entities would constitute business reorganisations

Evaluation should be carried out before the reorganisation takes place to mitigate potential tax and Transfer Pricing risks e.g. exit tax, local Transfer Pricing adjustments as well as discrepancies with regulatory filings

Business reorganisations

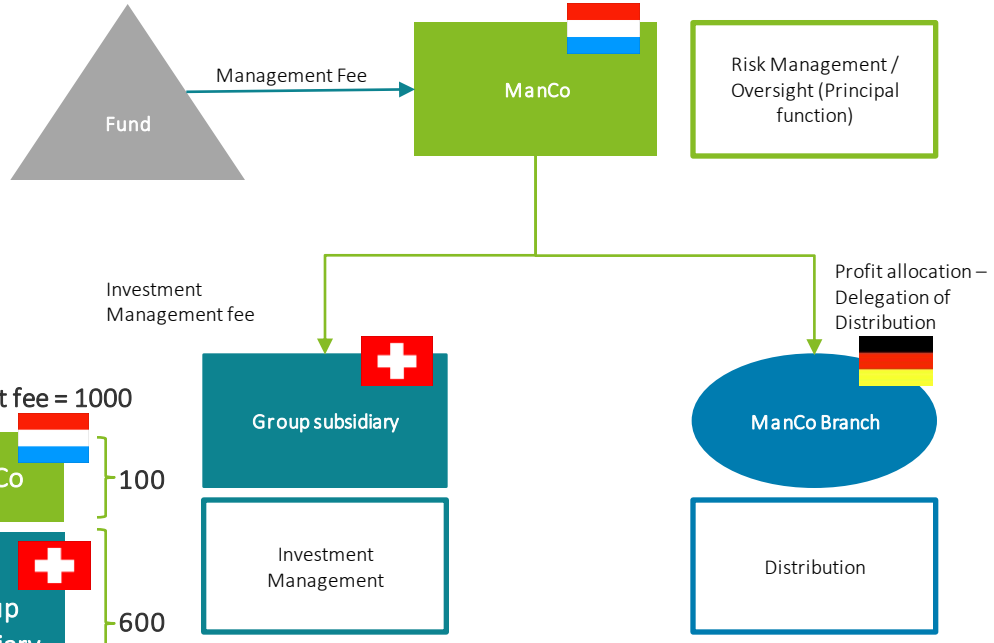
Before reorganisation

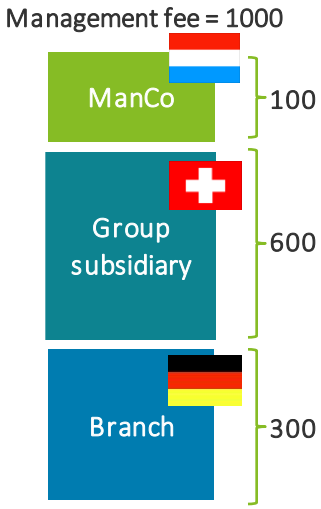




ManCo has historically carried out Investment Management functions. Investment Management remuneration represents a majority share of the Management Fee

After reorganisation





ManCo's profit potential has decreased as a consequence of the reorganization – should it be compensated? What did the relocation of Investment Management function entail?

Impact of Covid-19 for regulated structures

In order to address the implication of the COVID-19 pandemic, the OECD issued guidance to provide several policy recommendations. In particular, it released "Guidance on the transfer pricing implications of the COVID-19 pandemic" ("TP Guidance") to clarifies and illustrates the practical application of the arm's length principle to the current economic context and the "Guidance on tax treaties and the impact of the COVID-19 crisis" to clarify the application of the existing rules and the OECD Commentary on concerns related to the creation of permanent establishments.

Comparability analysis

"… The unprecedented change in the economic environment following the outbreak of COVID-19 creates unique challenges for performing comparability analysis." *(TP Guidance, para. 9)*

- Reliability of historical data used in comparability analyses
- Sources of information to support the setting of arm's length prices
- Practical approaches to address information deficiencies
- Potential impact on the economic analysis for supporting activities (e.g. TNMM C+ for advisor/sub-advisor)

Allocation of losses

"The allocation of losses … can give rise to dispute and … requires consideration given the probable increase in the frequency and magnitude of losses in the current economic environment." *(TP Guidance, para. 34)*

- When performing a comparability analysis, consideration may be needed of how exceptional costs arising from COVID-19 should be taken into account
- Negative impact on the value of the AuM, → lower management fees, that could not suffice to cover costs along value chain
- Potential tension with the regulatory dimension, due to minimum capital and liquidity requirements

Advance pricing agreements ('APAs')

"It is important to determine to what extent, if any, the change in economic conditions affects the application of existing APAs. Taxpayers and tax administrations negotiating APAs that apply to FY2020 may also face questions about how the economic conditions arising from COVID-19 should be taken into account. " *(TP Guidance, para. 87)*

- Existing APAs (e.g. principal function for ManCo/AIFM under the delegation model, distribution fees, etc.) should be respected unless a breach of critical assumptions has occurred
- In case of a failure to meet critical assumptions of an APA potential outcomes would be: (i) revision, (ii) cancellation or (iii) revocation of the APA

The future of work

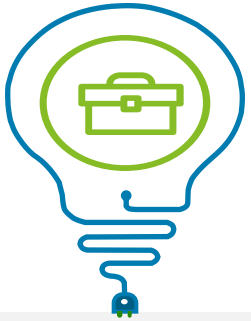
Changes in work practices prompted by the COVID-19 pandemic can result in the creation of a Permanent Establishment ('PE')

- Fixed PE risk: a home office may qualify as a fixed PE for an enterprise in some specific circumstances.
- Dependent Agent PE ('DAPE') risk: the activities of an individual temporarily working from home for a non-resident employer might give rise to a DAPE, if the employee habitually concludes contracts on behalf of the enterprise (e.g. marketer/employees engaged in distribution activities).
- Profit attribution to the PE

Intangible assets for regulated structures

The international developments at OECD level introduced new concepts regarding the ownership and valuation of intangibles, as well as a substantially broader definition of intangibles with significant implications for tax and transfer pricing purposes in the asset management industry.

Marketing-related intangibles

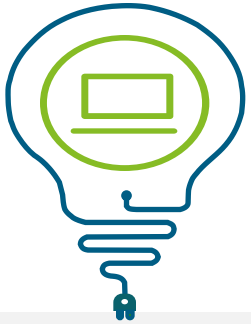


- Marketing-related intangibles (e.g. trade names and trade marks) could qualify as intangibles for TP purposes and, in case, an adequate TP policy should be established (e.g. license fee, service fee).
- The question of the value of marketing-related intangibles needs to be examined on a case-by-case basis depending on the facts and circumstances and on their contribution to the value creation.
- Completeness and appropriateness of inter-company agreements and of the existing transfer pricing documentation (even the non remuneration needs to be supported and documented)

Impact of technology

- Technology (e.g. algorithmic models for portfolio management tools, robo-advisors and artificial intelligence facilitating investment decisions and product selection) continues to be a game changer
- Assess whether technology needs to be characterised as a key intangible in order to ensure the appropriateness of the transfer pricing positions regarding remuneration for the ownership and use of intangibles (cost recharge vs. license fee)
- Consistency between tax-related communication and other channels (especially for investor relations and regulatory purposes)

Luxembourg IP Box regime



- Activities related to the creation of potential intangibles (e.g. the development of software, investment platforms, etc.) could be eligible for the Luxembourg IP box regime (Qualifying income would benefit from 80% exemption proportional to nexus ratio)
- Strategic development activities and DEMPE functions should be centralised in order to ease the identification of the economic ownership of intangibles
- Transfer pricing analysis documentation to determine or sustain qualifying assets and IP income or determine arm`s length intercompany royalties

Deloitte.