New tax regulations for investment funds

Austria, France, Germany, Ireland, Luxembourg, Netherlands, United Kingdom, Switzerland

2013 was dominated by the changes triggered by the Alternative Investment Fund Managers Directive (AIFMD). Hence, this article mainly focuses on the amendments to regulations and the fiscal consequences of AIFMD for the taxation of investment funds. Other amendments to the existing taxation rules for investment funds encompass regulations aimed at fine-tuning the tax assessment provisions, as well as correcting clerical errors in previous tax legislation.

Austria

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In the course of the implementation of the AIFM Directive (2011/61/EU) into national law, two major changes with regard to the taxation of mutual funds have been incorporated into the Austrian Mutual Fund Act. Moreover, additional changes for mutual funds will enter into force for funds´ business years starting in 2013, which were previously implemented into the Austrian Mutual Fund Act, as part of the last tax reform in Austria.

Changes following implementation of the AIFM Directive

- **Definition adopted for foreign mutual funds**
  Foreign mutual funds that are set up as UCITS (Undertaking for Collective Investment in Transferable Securities) or AIFs (Alternative Investment Funds) qualify as foreign mutual funds from a tax viewpoint, irrespective of the fund's legal set-up and risk diversified portfolio. It has yet to be decided whether the term 'AIF' will relate to the regulatory definition, but if it does, it is unclear how this can be proved in practice, as only alternative investment fund managers obtain a licence or a registration from the regulatory authorities, but not the respective AIF.

  Foreign vehicles that are not set up as UCITS or AIF can qualify as foreign mutual funds if the assets are invested in accordance with the principles of risk diversification, and if the following criteria are met:

  - The vehicle is not subject to a comparable corporate tax (the corporate tax rate is currently 25%) in the jurisdiction where it is set up
  - The profit of the vehicle is subject to a corporate tax rate that is 10 percentage points lower than the Austrian corporate tax rate (currently 25%), or
  - The vehicle is tax exempt in the jurisdiction where it is set up

Tax transparent vehicles that are not taxed directly in the jurisdiction where they are set up do not have to go through the above-mentioned criteria test; they are treated as transparent mutual funds in Austria in the case of a risk diversified portfolio.

The above-mentioned definition is applicable for funds´ business years starting on or after 21 July 2013.

- **75% reduction in loss carry forwards**
  It will only be possible to offset 25% of loss carry forwards that could not be set off against taxable gains in funds´ business years starting in 2012. This will result in a cut off of loss carry forwards of 75%. This new tax rule will only apply to Austrian private investors; institutional investors will retain a 100% set-off of loss carry forwards. The following amounts of taxable gains can be used to set off losses for Austrian private investors:

  - Funds´ business years starting in 2012—40% of realised net gains from equities and equity-linked derivatives
  - Funds´ business years starting in 2013—50% of all realised net gains
  - Funds´ business years starting in 2014 and beyond—60% of all realised net gains

  The amount of the 25% loss carry forward for private investors will have to be reported by the Austrian tax representative of the foreign mutual fund with separate codes to the Austrian Kontrollbank.

  The above described principles only apply to realised gains that are part of Deemed Distribution Income (DDI). In the case of distributions relating to business year 2013, the entire amount of distributed gains will be taxable.

Changes for funds´ business year 2013 already implemented

- **Equalisation on dividends and gains**
  Equalisation amounts on dividends and realised gains and losses (see above) will be taxable, and will be part of the DDI starting with business year 2013. In previous business years, only equalisation amounts on net interest income have been part of the DDI.

- **Amended taxation of distributions**
  Distributions relating to business year 2013 and beyond are deemed to have been made out of the following components in the following order, without exception:

  1. Current income (interest, dividends deducted from expenses)
  2. Income carry forwards (tax-free if already taxed as DDIin the past)
  3. Realised gains (including tax-free gains as mentioned under the section above, i.e. distributed gains will always be treated as taxable distribution)
  4. Gains carry forwards
  5. Substance (tax neutral)

  Tax-free parts of distributions will reduce the acquisition cost of shares in the fund (if acquired by an Austrian private investor after 31 December 2010) in order to avoid a double non-taxation in the event of redemption, i.e. the tax-free distributions will qualify as a taxable capital gain in the event of redemption.

The system of taxation of mutual funds in Austria has not changed significantly, there are some amendments entering into force for business year 2013 or business years starting on or after 21 July 2013

France

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New tax measures are currently being discussed by the French Parliament for the vote of the 2014 budget. The final vote will take place shortly, but these rules could still be subject to modification

General measures

Increase in the exceptional Corporate Income Tax (CIT) surcharge

Companies with annual revenue exceeding €250 million are currently subject to an ex-ceptional CIT surcharge at a rate of 5% until 30 December 2015.

The current 5% rate of this surcharge is set to increase to 10.7%. This would lead to an effective CIT rate of 38% (instead of 36.1% currently).

Exceptional tax on high salaries paid by companies

A 50% tax will be levied on the portion of remuneration paid to employees exceeding €1 million per year per individual. This annual tax is to be paid by companies and will apply to remuneration paid or attributed in 2013 and 2014, with a cap set at 5% of annual revenue.

It is worth noting that the definition of 'remuneration' falling within the scope of the new tax is quite broad and includes benefits in kind, bonuses and stock options or free shares.

Specific measures relating to the asset management industry

New tax regime of capital gains on shares applicable to individual investors tax resident in France

The asset management industry could be directly impacted by the new tax regime of capital gains on shares. The general objective is to apply income tax rules and rates to capital gains.

This new regime clarifies the tax rebates regime, which depends on the holding period.This favorable regime applies to the transfer of shared equity rights and to the distribution of assets by capital risk funds (Fonds Communs de Placement à Risques or FCPR) and the distribution of capital gains by French or foreign collective investment schemes.

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Holding period and tax rebates

Holding period	Rebate
Less than 2 years	0%
2 to 8 years	50%
Over 8 years	65%

However, in some circumstances, it might prove difficult to meet the conditions needed to benefit from this exemption. For example, capital gains deriving from the sale or repurchase of shares/units in collective investment schemes (UCITS type) only benefit from the exemption regime if an investment ratio is met (i.e. 75% of the investment must be in shares). This investment ratio should be met before the end of the second fiscal year following the creation of the fund. For funds created before 1 January 2014, this investment ratio has to be met before the end of the first fiscal year that ends after 1 January 2014.

Unfortunately, the favourable tax regime applicable to the re-investment of the proceeds of share disposals where shares have been held for more than eight years is to be removed. From January 2014, capital gains will no longer benefit from this incentive.

Other proposals, such as the introduction of a special 30% withholding tax on the distributions of capital gains for non-residents were rejected.

The extension of the scope of the French FTT has also been rejected so that it would not get in the way of the already difficult discussions on the European FTT.

Summary of the items that can give rise to a tax rebate

	Rebate/discount regime	Comments
Shares	Yes	No specific conditions
Equity rights or instruments	Yes	No specific conditions
Distribution of assets by a capital risk fund	Yes	No specific conditions
Disposal of fund units Distributions of capital gains by a fund	Yes	Funds have to respect an investment ratio of at least 75% in qualifying shares
Disposal of shares/units in a capital risk fund (FCPR) Distribution of capital gains by a capital risk fund	Yes	Funds have to respect an investment ratio of at least 75% in qualifying shares, except for certain capital risk funds

Germany

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A draft law was passed in respect of changes to the German Investment Tax Act (GITA), dated 24 October 2013. These changes, adjusting tax regulations in order to match with the new provisions, were anticipated by the Financial Investment Code (Kapitalanlagegesetzbuch) replacing the German Investment Act (GIA). The new investment tax law is coextensive with the former draft AIFM Tax Amendment Act, which became invalid at the end of the previous legislative period on 22 September 2013. After the re-election of the conservative Christian Democrats of Chancellor Angela Merkel, at the time of writing (December 2013), they will more than likely form a grand coalition with the Social Democrats.

Following the re-election of Chancellor Angela Merkel's Christian Democrats, the proposed amendments are due to come into force during the 2014 tax assessment period

As the old Investment Tax Act refers to the outdated GIA to some extent, for the time being there was a lack of certainty for some investment vehicles in determining and publishing the respective bases of taxation. The German Ministry of Finance (BMF) therefore issued a circular letter on 18 July 2013 dealing with transitional rules, stating that the tax authorities will not make any challenges if regulations contained in the outdated Investment Tax Act were used for the taxation of investors in the respective vehicles that comply with the old GIA. This shall be valid until the aforementioned replacement tax law has passed the legislation and comes into force (before 31 December 2013).

Changes to investment tax law during 2013

- **Tax exemption of dividends and capital gains**
  The legislation passed a change in law as an adaption within the Corporate Tax Act regarding the tax exemption of dividends and capital gains for corporations. After 1 March 2013, the 95% tax exemption for dividends is only applicable to shareholdings greater than 10%. In general, this also applies to mutual funds. Under the new law, the fund administrator has to calculate and disclose the old AKG1 for individual business investors and partnerships as well as a new AKG2 for corporations.

- **Cost allocation of performance fees**
  In its circular dated 3 April 2013, the BMF clarified the existing law concerning the allocation of performance fees relating to fund investments. Accordingly, the performance fee has to be allocated in accordance with the contractual arrangement within the fund documents (prospectus, supplements, etc.), i.e. it has to be allocated to realised gains to the full extent, if the calculation of the fee is only based on realised gains. Alternatively, the performance fee has to be allocated partly to realised gains and partly to ordinary income, or to the full extent to ordinary income, if the calculation is based on those components.

Changes to investment tax law until 31 December 2013

- **General cost allocation**
  Under current rules, it is possible to allocate general costs primarily to ordinary taxable income (e.g. dividends, interests), and thus reduce the investor's taxable deemed distributed income derived from fund investment.

  According to the new rules, general costs would be allocated to taxable ordinary income as well as to capital gains. If the ordinary income and the sum of capital gains and losses are negative, there is a fixed ratio of 50% for the allocation between ordinary income and capital gains. This means that the option to categorise 10% of indirect costs as non-deductible expenses would be abolished. However, there will be no changes to the allocation of direct costs.

- **Mandatory source order for distributions**
  The new investment tax law contains the following ruling: for tax purposes, a distribution is deemed to stem from all income of the current and previous years, until substance, within the meaning of the share-class capital, is affected.

- **Anti-abuse rules applicable to bond-stripping structures**
  A further paragraph of the new law aims at preventing certain structures involving the change in ownership rules of bond coupons, known as 'bond-stripping structures'. Until now, these structures have been used to generate taxable income from the disposal of stripped interest coupons at the fund level, which can be used as deemed distributed income to be offset against other losses, thereby avoiding forfeiture of the investor's tax losses under special regulations of the Corporate Income Tax Act. Future losses from the disposal of fund units could be set off against other taxable income.

- **Conservation of the status quo**
  There are reliefs, which are beneficial for the fund industry, regarding the proposed grandfathering rules. There is a right of continuance if partnership units were in the fund portfolio before the parliamentary decision regarding the draft law. Even more important is a minimum grandfathering rule for three years, for (sub-)funds in issue before 22 July 2013 (coming into effect of the Financial Investment Code).

Ireland

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REITS

Finance (No. 1) Act 2013, introduced Real Estate Investment Trusts (REITs) into Ireland. This is a good news story for the Irish fund and property sectors that also provides a platform on which a world class REIT environment can be built and refined.

The REIT regime provides tax exemption in respect of the income and chargeable gains of a property rental business held within a company that satisfies a number of conditions. Dividends paid by a REIT out of its rental income will be subject to a 20% dividend with holding tax, for which recipients will be liable. However, in many cases it is possible to reduce the rate of withholding tax under the terms of a relevant treaty between Ireland and the investor jurisdiction (see paragraph on treaties below). Capital gains made by non-Irish resident investors on their disposal of shares in the REIT are not taxable in Ireland. Transfer tax of 1% applies to any issuance or transfers of shares in the REIT.

The REIT brand is well recognised globally, and the Irish regime has been introduced with a view to attracting international investors to the Irish property market, as well as the international property market. Through the REIT structure, Irish financial institutions should have a growing number of opportunities to find buyers for distressed property assets, freeing up much needed capital for investment in other projects. The first Irish REIT was successfully launched on 18 July 2013, and a number of others are in the process of being established. We expect REIT activity to ramp up significantly in 2014, following the success of the first entrants.

Investment Limited Partnerships

In response to calls by the Irish international fund industry, the Finance (No. 1) Act 2013 included measures to treat Irish funds established as Investment Limited Partnerships (ILPs) in accordance with the Investment Limited Partnerships Act 1994 as transparent for Irish tax purposes. The tax treatment of ILPs after this date will be very similar to the treatment of Common Contractual Funds (CCFs).

From an Irish tax perspective, ILPs are not chargeable to tax in respect of income and gains (i.e. profits) on underlying investments, but those profits are treated as accruing to the unitholders of the ILP in proportion to their relative investment in the ILP, as if the unitholders held a corresponding share in the underlying investments directly.

This new tax treatment applies to ILPs authorised by the Central Bank of Ireland on or after 13 February 2013. This important change to the ILP framework will result in a tax transparent fund structure suitable for private equity and real estate investments, and sends a clear and positive message that Ireland is AIFMD ready and open for business.

Common Contractual Fund (CCF)

The Common Contractual fund (CCF) is an Irish regulated asset pooling fund structure. Asset pooling enables institutional investors to pool assets into a single vehicle fund with the aim of achieving cost savings, enhanced returns and operational efficiency through economies of scale. Experience of existing CCFs shows a saving of 10-20 basis points.

The first Irish REIT was successfully launched on 18 July 2013, and a number of others are in the process of being established

A CCF is an unincorporated body established under a deed whereby investors are 'co-owners' of underlying assets that are held pro-rata to their investment. A CCF is usually established by a management company and investors must not be individuals, i.e. only institutional investors are permitted. CCFs are authorised and regulated by the Central Bank of Ireland and can be structured as a UCITS or a non-UCITS fund. A CCF is not a separate legal entity and is transparent for Irish legal and tax purposes.

As the CCF is fiscally transparent, it is therefore exempt from Irish tax on its income and gains. Investors in a CCF are treated as if they directly own a proportionate share of the underlying investments of the CCF. Under Irish tax law, the profits that pertain to the CCF are therefore treated as arising or accruing to the investors in the CCF as if they had never passed through the CCF. As the CCF is tax transparent, it is the double tax treaty between the investor jurisdiction and investment jurisdiction that is relevant for treaty relief.

Many new Irish double tax treaties confirm the transparency of the CCF in treaty partner locations. To date, at least 19 jurisdictions, including the United States, recognise the Irish CCF as fiscally transparent.

Rates of investment undertaking tax

Finance (No. 2) Bill 2013 introduced an increase in the rate of tax withheld on payments from Irish resident funds to Irish resident investors in respect of distributions, redemptions, transfers and deemed disposals. For Irish funds, which previously withheld tax at 33% or 36%, depending on the frequency of the payments in question, a new rate of 41% will now apply to all payments to investors, regardless of the frequency of those payments. The rate applicable to 'personal portfolio investment undertakings' increases from 56% to 60%, but increases to 80% where the payment has not been correctly included in the income tax return.

The increased rates will apply to payments/deemed payments made on or after 1 January 2014.

Mandatory reporting for Irish funds

The Irish tax authorities issued a new reporting obligation for Irish funds. This is being commonly referred to as Section 891C Reporting. Irish domiciled funds are now required to report details of any Irish resident investors to the Irish Revenue Commissioners on an annual basis. Details are required to be submitted by 31 March each year in relation to the fund itself, the Irish resident investors and the investment held by each Irish investor.

New tax treaties

Ireland continues to expand its network of double taxation treaties, 70 of which have now been signed. The legal procedures to bring our most recent treaties into force—treaties with Egypt, Ukraine and Thailand—are now being followed. In addition, negotiations for new agreements with Azerbaijan, Jordan and Tunisia are ongoing.

The ever-increasing number of Irish treaties serves to improve returns for investors in Irish funds, with Irish funds recognising the benefit of reduced rates of foreign tax in treaty countries in many cases.

Luxembourg

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In Luxembourg the AIFMD was transposed through the law dated 12 July 2013. The new law includes various tax and legal aspects not directly required by the directive, but which are aimed at strengthening Luxembourg's position as a fund centre for UCITS, as well as for alternative fund managers. The law includes the following measures:

Creation of the 'special limited partnership' (SCSp)

The draft law modifies the Law of 10 August 1915 on commercial companies, including:

1. A modernisation of the legal regime applicable to common limited partnerships or SCS *(Sociétés en Commandite Simple)*
2. A new vehicle, the special limited partnership or SCSp *(Société en Commandite Spéciale)*

While most of the provisions applicable to these entities are similar, the main difference between the SCS and the SCSp is that the SCSp does not have a legal personality. The SCSp has been more particularly envisaged for unregulated funds, specialised investment funds (SIFs) and investment companies in risk capital (SICARs). The main advantage of the SCSp is that it is comparable to the Anglo-Saxon partnership model widely used for fund structuring, especially in the private equity and real estate investment sectors.

From a tax standpoint, the primary measure of Luxembourg's AIFM law is the full tax transparency of the SCS/SCSp for Corporate Income Tax (CIT), Municipal Business Tax (MBT) and Net Wealth Tax (NWT) purposes. In addition, the distribution of dividends by a SCS/SCSp is not subject to withholding tax. Full tax transparency applies when the corporate GP of the SCS/SCSp owns less than 5% of the partnership interests, and when the SCS/SCSp does not carry out a commercial activity.

Introduction of a new tax regime for carried interest

Aside from clarifying the Luxembourg tax regime applicable to carried interest paid to employees of AIF managers and to management companies of an AIF, the AIFM law introduces a beneficial temporary regime.

Beneficial temporary regime

Beneficiaries	Employees of AIF managers and management companies of an AIF
Tax rate applicable to carried interest	Progressive rate up to 10.335% (extraordinary in-come regime)
Conditions	Beneficiaries are those who: • transfer their tax residence to Luxembourg between 1.1.2013 and 31.12.2018 • have neither been a Luxembourg tax resident nor subject to taxation on their professional income in Luxembourg during the 5-year period preceding 2013 • did not receive any advance tax payment relating to their carried interest • can demonstrate that prior to the payment of their carried interest, committed capital has been fully repaid to investors
Length of the regime	11 years from the year the beneficiaries take on the position in Luxembourg that entitles them to the carried interest

- **Capital gains**
  Capital gains that the beneficiaries of carried interest (whether or not they benefit from the favourable regime) may derive from the sale or redemption of their shares/units if the AIF are taxable according to the usual tax regime applicable to capital gains, i.e.:
  1. exemption if the shareholding did not exceed 10% at any point in time during the five-year period prior to the sale or redemption, and
  2. the holding period exceeds six months

- **Combination with the 'highly skilled worker' regime**
  Combined with the advantages granted by the revised tax regime for highly skilled workers, Luxembourg—which is a long-standing location for investment funds—becomes a location of choice for fund managers as well. Whereas the tax regime for highly skilled workers may already lead to substantial yearly savings of personal income tax for an executive whose compensation package is properly structured, this executive would also save 75% tax on carried interest through the beneficial temporary regime

Broadening the VAT exemption scope for management services rendered to funds

From a VAT perspective, the objective of the AIFM law is to extend the VAT exemption scope of the previous eligible vehicles to the assimilated investment vehicles located in another EU member state, as well as to any AIF, as defined in the law. The anticipated goal of that measure is to avoid any VAT distortion of competition between the management of investment vehicles registered either in Luxembourg or another EU member state. A Luxembourg-based management company delegating part of its management tasks (still viewed as a 'whole') to a third-party provider (established in Luxembourg or abroad) continues to benefit from the VAT exemption on management services if all the VAT conditions are met, irrespective of whether the relevant investment vehicle is registered in Luxembourg or in another EU member state.

There is no doubt that the granting of a VAT exemption to the management of AIFs, together with the increase of the cross-border management to (eligible) EU investment vehicles, could impact the corresponding input VAT deduction right of the managers. In this respect, the Luxembourg VAT authorities issued Circular 765 dated 15 May 2013 and consider that the use of the general prorata method (yearly ratio of the taxable transactions, in respect of which VAT is deductible over the total turnover within the scope of VAT) remains applicable only in relation to overhead expenses that cannot, by nature, be allocated to any activity in particular. As from 2013, taxpayers must switch to an alternative methodology based on appropriate and objective allocation keys. Luxembourg-based management companies with both taxable and exempt activities should closely monitor this.

On 7 November 2013, the Luxembourg VAT Authorities issued Circular 723 ter regarding the application of the VAT exemption (Article 44§1 d) of the Luxembourg VAT Law (LTVA) in respect of risk management services for investment funds. Risk management services rendered to investment funds benefit from a VAT exemption under Article 44§1 d) LTVA.

Such services should include the monitoring and measuring of risk of positions and of their contributions to the overall risk profile of the portfolio (as defined in Article 51 of the Directive 2009/65/EC). The fund management VAT exemption should similarly apply to risk management services rendered to alternative investment funds (Article 15 of the Directive 2011/61/EU).
The Luxembourg VAT authorities confirmed that risk management services are to be seen, for VAT purposes, as being part of fund management. Risk management services outsourced by the management company must be specific and essential to the management of (alternative) investment funds (as further defined in Circular 723 bis 30 April 2010) in order to benefit from the fund management VAT exemption.

In any case, the application of this exemption for outsourced services should be analysed on a case-by-case basis, by considering Circulars 723, 723 bis and 723 ter.

Cross-border management of AIFs

- In a similar way to the UCITS regulations, under the AIFM law, an authorised AIFM established in Luxembourg is allowed to manage AIFs established in other EU member states. From a tax point of view, these cross-border management services should not create any management or control issues. The AIFM law specifically states the principle of non-tax liability for those AIFs established outside Luxembourg that have their effective centre of management or central administration in Luxembourg
- The AIFM law also sets out minimum substance requirements to be met at the level of the AIFM that illustrate the convergence between the substance required from a regulatory perspective and the substance required from a tax viewpoint

Netherlands

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This year there have been a few positive changes regarding the Dutch FBI (fiscal investment institutions or fiscale beleggingsinstelling). FBIs are subject to a 0% corporate income tax rate in the Netherlands, and they have access to the Dutch tax treaty network. This has made it a very tax-efficient fund vehicle for (high) dividend as well as real estate investments. Of course certain requirements must be met, but some of these have or will become easier to fulfill.

Performing ancillary activities for RE-FBIs

FBIs were only supposed to perform passive investment activities such as real estate leasing. They were previously not allowed to perform ancillary activities related to real estate or to hold 100% of the shares in a subsidiary that is engaged in business activities, because these did not qualify as 'passive investment activities'.

In the 2014 tax plan, changes are proposed that will enable FBIs to offer additional services relating to the development and management of their investment property. FBIs will be allowed to do this using a 100% (regular taxed) subsidiary whose purpose and actual activities consist of performing ancillary activities directly related to the real estate investments made by the FBI. For example, such activities could be cleaning, catering and reception services. It will therefore be easier for FBIs to act as the parent company of a (cross-border) real estate fund structure.

Less stringent shareholder requirements following the implementation of the AIFMD

The Netherlands implemented the AIFMD earlier this year. This could prove to be an interesting development for the use of FBIs.

There have always been different (less stringent) shareholder requirements for FBIs that were listed or that were supervised by the Netherlands Authority for the Financial Markets *(AFM or Autoriteit Financiële Markten).* In the past, only a relatively small number of FBIs fulfilled the criteria to use the less stringent shareholder requirements. The implementation of the AIFMD has placed a lot of FBIs under the supervision of the AFM. So most FBIs (being a UCITS or an AIF) will now qualify for these more favourable shareholder requirements. This means that an individual shareholder can hold up to 25% of the shares of a FBI. Legal entities are allowed to own up to 45% of the shares if the shareholder is taxed for CIT-purposes, or up to 100% in the case of a tax-exempt shareholder.

Real estate investment funds: no transfer tax

If shares in a real estate investment fund are sold, a Real Estate (RE) transfer tax might be levied. There was already an exemption to this rule for the transfer of shares in a RE corporation (funds with legal personality), as long as less than a third of the shares were bought. For RE funds without legal personality, the exemption rules were more complex and could not always be easily fulfilled. In the 2014 tax plan, it has now been proposed that the 'up to 1/3-exemption' will apply as long as the real estate fund is a collective investment fund regulated by the Dutch Financial Supervision Act *(Wet financieel toezicht or Wft).*

Withholding tax reclaim opportunities

Last year, the Finnish investment fund case required special attention. According to the Court of Appeal in Den Bosch, a Finnish investment fund was entitled to a full refund of Dutch withholding tax on dividends, because it was comparable to the domestic situation of exempt corporations which are entitled to such a refund. Recently, the Dutch Supreme Court rejected the Finnish investment fund's reclaim. Contrary to the Court of Appeal, the Dutch Supreme Court decided—without putting any preliminary questions to the European Court of Justice—that the mere fact that the fund was exempt from tax in Finland did not impose an obligation on the Netherlands to refund the Dutch withholding tax on dividends. Moreover, it ruled that the Netherlands could apply a test to see whether the fund would be exempt from tax—and thus entitled to a refund—if it were located in the Netherlands. The outcome of that test was negative. The Finnish investment fund would be fully subject to tax. Finally, the Dutch Supreme Court also considered whether the Finnish investment fund was comparable to a Dutch FBI, which is—under certain conditions—entitled to an 'indirect refund' of Dutch withholding tax. The Dutch Supreme Court decided that the Finnish investment fund was not comparable, because—unlike a FBI—it had not distributed its annual income to its shareholders.

In another case of the Court of Appeal in Den Bosch, it was decided that a Belgian private person was entitled to a partial refund of the Dutch withholding tax deducted on portfolio dividends. The Court of Appeal considered that because a Dutch resident could have credited the Dutch withholding tax, the Belgian should not be in a worse position. This case is currently pending before the Hoge Raad as well.

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In its 2013 budget, the UK government announced an investment management strategy, covering marketing, regulation and taxation, with the intention of improving the attractiveness of the United Kingdom as a fund domicile.

This included an undertaking to make the UK tax system for investment management fairer, simpler and more streamlined, and therefore a number of proposed measures were consulted on in summer 2013.

Cross-border management of alternative investment funds

In response to the introduction of the 'management company passport' under UCITS IV, which enables a UCITS fund to be managed cross-border, the United Kingdom introduced legislation (s363A TIOPA 2010) in July 2011 to enable an offshore UCITS fund to be managed from the United Kingdom without there being a risk that it would cause the fund to be UK tax resident. This has been well received by the industry and we have seen a number of investment managers capitalise on the legislation.

HM Revenue & Customs (HMRC) consulted this summer on the government's proposals to extend these rules to offshore non-UCITS funds that have a UK Alternative Investment Fund Manager (AIFM) or a UK branch of a non-UK AIFM, i.e. it will be possible for an offshore non-UCITS fund to be managed by a UK AIFM without there being a risk that this could cause the fund to be UK tax resident. This will enable the United Kingdom to take advantage of the opportunities provided by the Alternative Investment Fund Managers Directive (AIFMD). We are expecting draft legislation to be included in the Finance Bill 2014.

Gross interest distributions from UK funds

UK open-ended investment companies (OEICs) and authorised unit trusts (AUTs) are permitted to make interest distributions (rather than dividend distributions) in certain circumstances. The fund is generally required to withhold basic rate income tax at 20% on interest distributions. However, where certain conditions are met, which are designed to ensure that the investor is non-UK resident, the interest distributions can be made gross. This can create a disincentive for non-UK distributors to market UK bond funds, because the distributor would need to determine whether any of the investors are UK residents.

HMRC consulted proposals to enable gross interest distributions to be paid by UK funds marketed exclusively outside the United Kingdom. There would be no requirement for the distributor to establish the tax residence of investors who have non-UK addresses. HMRC believes that this proposal should help interest-paying UK funds attract more non-resident investors. Regulations were laid in December 2013 and draft HMRC guidance is expected to be published in due course.

Abolition of schedule 19 Stamp Duty Reserve Tax

In its 2013 budget, the UK government announced the abolition of schedule 19 Stamp Duty Reserve Tax (SDRT)—the UK fund specific stamp duty that arises on redemption of shares/units in OEICs and AUTs starting April 2014. This is very positive news for the attractiveness of UK authorised funds, and something that the industry had been requesting for many years. The tax has a headline rate of 0.5%, but owing to various reduction fractions, the actual rate is often much lower. We are expecting the draft legislation to be included in the Finance Bill 2014.

Previously, UK investors relied on the ‘roll-over relief’ rules that applied to reorganisations of normal corporates

Tax transparent funds

The UK update on the taxation of investment funds in issue 10 of Performance focused solely on a new UK tax transparent fund vehicle, formally known as Authorised Contractual Schemes (ACS). The legislation to introduce the ACS came into force in June 2013, and the UK financial regulator has been able to accept applications for authorisation from July. We have seen a great deal of interest from life insurance companies considering whether the ACS would present a suitable alternative offering, from pension schemes looking for a tax-efficient way to pool their investments and from investment managers seeking to rationalise their fund ranges while offering a tax-efficient solution to investors. At the time of writing, we eagerly await the launch of such a fund vehicle.

Exchanges, mergers and reconstructions

New legislation, effective from 8 June 2013, has been introduced to provide 'roll-over relief' on chargeable gains/losses arising on exchanges, mergers and schemes of reconstruction of collective investment schemes (which include both UK and offshore funds) for UK investors. Previously, UK investors relied on the 'roll-over relief' rules that applied to reorganisations of normal corporates. This generally worked, but there were areas of uncertainty in certain specific circumstances. This new legislation provides greater certainty and also legislates for the chargeable gains treatment of exchanges between share classes of the same sub-fund (previously reliance was generally placed on HMRC guidance for share class switches). With the exception of moving from hedged to unhedged and vice versa, UK investors can generally switch between share classes of the same sub-fund without crystallising a chargeable gains event.

Unauthorised unit trusts

Following consultations in 2011 and 2012, draft regulations amending the taxation of Unauthorised Unit Trusts (UUTs) and their unitholders were published in September 2013. UUTs can be either exempt or non-exempt, depending on the tax status of the unitholders. The changes are generally intended to prevent the use of non-exempt UUTs for tax avoidance by bringing them within the scope of corporation tax, and to simplify the rules as well as reduce existing administrative burdens for exempt UUTs and the investors. The changes will also require exempt UUTs to be approved by HMRC.

UK corporates investing in UK and offshore funds

As part of a wider consultation on the modernisation of the taxation of corporate debt and loan relationships, the UK government has proposed the abolition of two fund- specific rules: (i) the 'bond fund' rules—the rules that require a UK corporate to treat an investment in a UK or offshore fund as a loan relationship, where the fund holds more than 60% in interest-bearing assets at any time during the corporate investor's accounting period; and (ii) the 'corporate streaming' rules, which require a UK corporate investor receiving dividend distributions from a UK OEIC or AUT to treat the relevant percentage of the distribution as taxable, unfranked investment income and balance as non-taxable franked investment income.

An HMRC working group, on which Deloitte is represented, has been established to discuss the proposals and, at the time of writing the article, the discussions have focused on the proposals to abolish the 'bond fund' rules. These rules were originally introduced as a piece of anti-avoidance legislation, but it was understood that they had been subject to abuse, hence the proposals for their abolition. However, it has been acknowledged that this would create a mismatch for UK corporates between investing in interest-bearing assets directly and via a collective investment scheme. This is of particular concern to UK life insurance companies.

It was announced in the Autumn Statement that the government will introduce legislation to enhance, clarify, rationalise and prevent abuse of the 'bond fund' rules, and to permit corporate investors to make a claim in certain circumstances to disapply the rules. We are expecting the proposed changed to the legislation to be included in Finance Bill 2014.

The proposed abolition of the corporate streaming rules is due to be discussed by the working group in the new year. Concerns have been raised by the life insurance industry in particular, as the corporate streaming rules effectively enable them to reclaim the tax imposed on 'balanced funds'. The corporate streaming rules are also fundamental from a tax efficiency perspective for life companies investing in property alternative investment funds (an elective regime for UK OEICs that invest in property).

Management fee rebates

To coincide with the Retail Distribution Review (RDR), HMRC issued a policy statement, followed by regulations, to clarify the obligation to withhold tax on rebates of management fees. Generally, there should be a requirement to withhold basic rate income tax at 20% where the rebate meets the definition of 'qualifying annual payment' and it is not an 'excepted payment' This was not the approach that had previously been adopted by the industry as a rule. However, the RDR should indicate a move to 'clean share classes' (i.e. with reduced management fees), such that the rebates of management fees that have a withholding tax obligation become less common.

> We are expecting the draft legislation to be included in the Finance Bill 2014

Switzerland

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Target funds—de minimis rule for tax reporting

In August 2013, the Swiss Federal Tax Administration (SFTA) introduced new de minimis rules for tax reporting. Generally, the Swiss tax system knows two categories of invest-ment funds: transparent collective investment funds and non-transparent ones. The first category includes contractual funds (FCPs), SICAVs and Limited Partnerships for Collective Capital Investments (LPCCIs). Such funds are considered tax transparent as long as they do not have direct holdings in real estate, since the profit arising from real estate (including rental income as well as capital gains from the disposal of real estate) located in Switzerland is taxed separately from any other income. The second category includes SICAFs, which are treated differently, namely as common limited companies.

Where collective investment funds invest in other collective investment schemes, different levels of income may result either from tax transparent collective investment schemes with distribution or with reinvestment. From the tax perspective, transparency must be ensured at all levels. All income generated by target funds and calculated or reported for Swiss or foreign collective investment schemes must be fully booked at the level of the fund-of-fund. Therefore, the fund-of-fund is obliged to provide an aggregated account each year, reflecting the proportionate investments in target funds.

Since some funds invest only occasionally and to a very limited extent in target funds, the new de-minimis rules have been introduced limiting the administrative burden for such investments. If overall, a collective investment scheme invests less than 10% of its total assets in target funds, then in the case of an investment of less than 3% of the total fund assets in a respective target fund, the following may be aggregated as taxable income in the fund-of-funds instead of the traditional reporting:

- Distribution target funds—all accrued distributions during the past financial year of the fund-of-funds
- Accumulation target funds—the positive difference in the net asset value in the past financial year; negative differences will not be taken into account

If such target funds have taxable values stated in the official list of securities (Kursliste) of the SFTA, these are to be aggregated.

The decision to apply the newly introduced deminimis rule per target fund must be adhered to for five years. Once this period expires, it will be automatically extended for another five years, provided the fund management company does not inform the SFTA about a change in the decision. The new deminimis rule for calculating taxable income may be used for the first time for financial years ending on 30 September 2013 or later.

Swiss accumulation funds—due date for withholding tax

Generally, dividends derived from units in a collective investment scheme are subject to Swiss withholding tax at 35% if the issuer of these units is a collective investment scheme with a registered office or principal management in Switzerland, or if the issuer is a foreign collective investment scheme and the collective investment units are issued together with a Swiss resident, e.g. a Swiss depositary bank. The annual due date for withholding tax is defined in the Swiss Withholding Tax Act; accordingly, the Swiss withholding tax liability arises at the time the taxable income is credited. According to SFTA circular letter no. 24, dated and in force since 1 January 2009 for withholding tax and stamp duty, and circular letter no. 25, dated and in force since 5 March 2009, for direct taxes, the time the taxable income is credited is defined as the end of the financial year.

For administrative and liability reasons, in the Swiss accumulation fund industry, the deadlines are now to be brought in line with distribution funds, i.e. the withholding taxes are:

- owed for the past financial year
- due within four months of the financial year-end (period for drawing up financial statements, auditing, reporting) when income is transferred to the account for income retained for reinvestment (point of reinvestment = due date)
- payable within 30 days of the due date, at the latest, five months after the financial year-end

In the case of contractual funds, SICAVs and limited partnerships for collective capital investments that reinvest income, the tax liability arises at the moment the taxable income is credited, i.e. at the end of the financial year or, in the case of liquidation, when the remaining liquidation proceeds are distributed.

For Swiss direct income tax purposes, individual investors must pay tax on the credited investment income corresponding to their proportionate investment (exceptions apply to capital gains that are reported separately and income that has already been taxed). In the case of Swiss collective investment schemes, the income is to be allocated to the tax year in which the withholding tax was deducted. Investors generally have the right to reclaim the withholding tax deducted by the accumulation collective investment schemes based on Swiss withholding tax law or an applicable double tax treaty.

FATCA impact on Swiss fund investment industry

Switzerland has agreed with the United States on an intergovernmental agreement (IGA) that would follow the Model II approach regarding the exchange of information under the U.S. Foreign Account Tax Compliance Act. Unlike Model I, the 'Swiss' Model II does not establish the automatic exchange of information between governments, as this was not agreed by the Swiss government. Instead, the Swiss government has agreed that it will ensure that Swiss financial institutions will be able to enter into a Foreign Financial Institutions (FFI) agreement with the U.S. Treasury Department to directly report to the IRS (to become a 'participating FFI'). In other words, the underlying mechanics of Model II are the same as under FATCA itself. However, the IGA with Switzerland provides some administrative reliefs for investment funds. Annex II to the IGA between Switzerland and the USA outlines that in the case of an investment entity that is a collective investment scheme subject to the collective investment legislation of Switzerland, and if all of the interests in the collective investment vehicle are held by or through one or more financial institutions that are participating FFIs, then that collective investment vehicle will be treated as registered deemed-compliant FFI.

The qualification as registered deemed-compliant FFI requires registration with the IRS, but it is not necessary for the collective investment scheme to enter into a FFI agreement.

VAT effect in connection with the revised CISA

On 1 March 2013, the newly revised Collective Investment Scheme Act (CISA) and Article 21, Paragraph 21, Subparagraph 2, Cipher 19, Letter f of the Value Added Tax Act (VATA) came into force. The main changes concern the VAT exemption for the distribution and management services provided to collective investment schemes. The CISA no longer differentiates between public and non-public distribution, and therefore all distribution services are now exempt from VAT. In addition, based on the fact that VATA now explicitly refers to Article 3, Paragraphs 1 and 2 of CISA, management services provided to foreign funds as well as those provided to Swiss funds could be VAT exempt. According to the old practice, management services provided to foreign funds were taxable, but taxed at 0% because the services were provided abroad. Whether the SFTA will introduce a new practice for management services for foreign funds is not yet clear; an announcement is still pending. If approved, under the new practice, management services provided to foreign funds would be VAT exempt and input tax refunds would no longer be available.