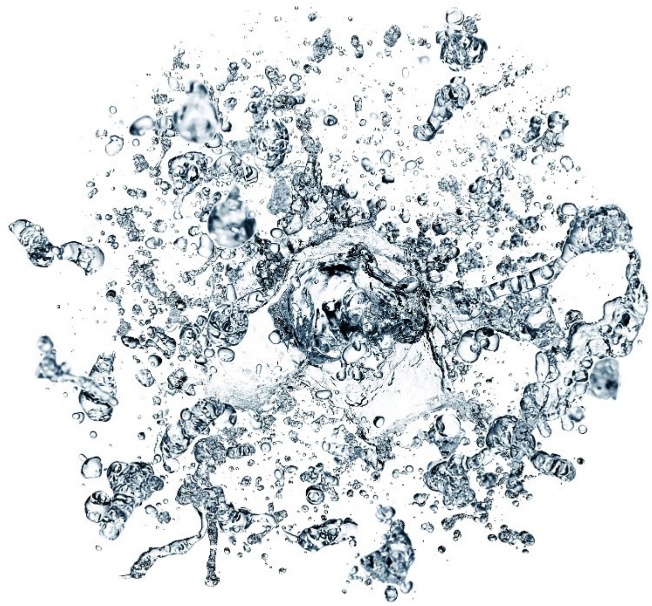
Deloitte.

International Tax for Asset Managers update
Summer 2016



A global focus on the investment management industry

In this issue:

India:

CBDT issues press release towards protocol for amendment of the Double Taxation Avoidance Agreement between India and Mauritius

The Central Board of Direct Taxes (CBDT) has issued a press release dated May 10, 2016, towards Protocol for amendment of the Convention, for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains, between India and Mauritius ("India Mauritius DTAA").

Background

Under the bilateral agreement existing between the two nations, capital gains from sale of shares can be taxed only in the place where the alienator (holder of the shares) is resident. Consequently, capital gains on sale of Indian shares by Mauritius entities are taxable only in Mauritius as per the DTAA, and as Mauritius generally does not levy capital gains tax, there is no capital gains tax on such transactions - this lead to structuring of investments into India through Mauritius (to avail the benefit of double non-taxation on exit) and also round-tripping of funds to India from Mauritius. India has been attempting to renegotiate the DTAA between India and Mauritius for many years.

Press Release

Source-based taxation of capital gains on shares

- With this Protocol, India gets taxation rights on capital gains arising from alienation of shares acquired on or after April 1, 2017, in a company which is resident in India. Further, protection to investments in shares acquired before April 1, 2017, has also been provided.
- In respect of such capital gains arising during the transition period from April 1, 2017, to March 31, 2019, the tax rate will be limited to 50% of the domestic tax rate of India, subject to the fulfillment of the conditions in the Limitation of Benefits (LOB) Article.
- Taxation in India at full domestic tax rate will be applicable for capital gains arising from April 1, 2019, onwards.

LOB

- The benefit of 50% reduction in tax rate during the transition period from April 1, 2017, to March 31, 2019, shall be subject to LOB Article, whereby a resident of Mauritius (including a shell / conduit company) will not be entitled to benefit of 50% reduction in tax rate, if it fails the main purpose test and bonafide business test.
- A resident would be deemed to be a shell/ conduit company, if its total expenditure on operations in Mauritius is less than Rs. 2,700,000 (Mauritian Rupees 1,500,000) in the immediately preceding 12 months.

Source-based taxation of interest income of banks

- Interest arising in India to Mauritian resident banks will be subject to withholding tax in India at the rate of 7.5% in respect of debt claims or loans made after March 31, 2017. Similar to capital gains tax exemption till March 31, 2017, interest income of Mauritian resident banks in respect of debt-claims existing on or before March 31, 2017, shall be exempt from tax in India.

Strengthening Exchange of Information

- The Protocol also provides for updating of Exchange of Information Article as per international standard, provision for assistance in collection of taxes, source-based taxation of other income, amongst other changes.

The CBDT has clarified that the Protocol is intended to tackle long pending issues of treaty abuse and round tripping of funds attributed to the India Mauritius DTAA, curb revenue loss, prevent double non-taxation, streamline the flow of investment and stimulate the flow of exchange of information between India and Mauritius. It will improve transparency in tax matters and will help curb tax evasion and tax avoidance.

Chile:

New regulation opens opportunities for foreign investors

Chile's Superintendence of Securities and Insurance issued a regulation, General Ruling N° 410 of 2016, on July 27, 2016, that clarifies the definition of "institutional investor" for purposes of the rules governing regulated investment funds.

Until the new regulation, the concept of institutional investor was not clearly defined in the law, and institutional investor status was granted almost exclusively to Chilean entities. The regulation, which applies as from the date of issuance, will allow qualifying foreign investors, foreign funds and collective investment vehicles to benefit from institutional investor status.

The Chilean tax system grants beneficial tax treatment to regulated investment funds:

- Such funds are not subject to corporate income tax;
- Profit distributions made by regulated investment funds to foreign unit holders are subject to a 10% single tax (instead of up to 35% for other investment vehicles). Gain on the disposal of the fund units also are subject to the reduced 10% rate; and
- Distributions of income from non-Chilean sources by regulated investment funds may be exempt from tax provided the regulated investment fund invests at least 80% of its assets abroad or in derivatives that do not have underlying assets in Chile.

Requirements to qualify as a regulated investment fund include that the fund be administered by a regulated fund administrator and have a minimum of 50 unit holders (although the minimum unit holder requirement is not applicable if an institutional investor participates in the fund).

The new rules expressly extend the definition of institutional investor to include the following foreign investors:

- Foreign entities that are subject to the regulations applicable to banks, insurance and reinsurance companies in their country of origin; and
- Foreign funds or other collective investment vehicles that have at least one of the following features:
  - The fund administrator or entity in charge of the investment decisions is subject, in its country of origin, to the supervision of an authority similar to the Chilean Superintendence of Securities and Insurance; or
  - The fund or investment vehicle itself is subject to the supervision of an authority similar to the Chilean Superintendence of Securities and Insurance.

The new regulation opens investment opportunities to foreign investors, foreign funds or collective investment vehicles that meet the requirements to qualify as an institutional investor and, therefore, to obtain favorable tax treatment through appropriate Chilean vehicles.

United States:

IRS Issues Notice 2016-42: Proposed Qualified Intermediary Agreement

IRS issues awaited Proposed Qualified Intermediary Agreement

On July 1, 2016, the IRS released Notice 2016-42 ("Notice"), providing the Proposed Qualified Intermediary (QI) Agreement that certain foreign persons may enter into with the IRS to simplify their withholding agent and payor obligations under chapters 3, 4, 61, and section 3406. The Notice and Proposed QI Agreement also provide substantive guidance and operational procedures for implementing the new Qualified Derivative Dealer (QDD) regime applicable to dividend equivalent payments under section 871(m) as announced in Temporary Regulations §1.871-15T(q) and §1.1441-1T(e)(6) on September 17, 2015.

The QDD regime will apply to all dividend equivalent payments received by an electing QI on its principal transactions only and will replace the Qualified Securities Lender regime provided in Notice 2010-46 that applies only to substitute dividend payments received on stock loans, stock repos and substantially similar transactions. The QDD regime will operate solely within the QI Agreement going forward. The Notice and Proposed QI Agreement also accommodate expansion of primary withholding responsibility for substitute interest payments received by QIs acting as principals to the transactions.

Two appendices for compliance and operational procedures

Appendix I to the Proposed QI Agreement provides a six-part set of compliance procedures for QIs including special sections exclusively for QDDs (Part V) and QI's that assume withholding on substitute interest payments (Part VI). Appendix II provides audit sampling requirements under a safe harbor and reporting requirements for sampling plans that do not utilize the safe harbor provisions of the Appendix.

Effective date

The current QI Agreement (contained in in Rev. Proc. 2014-39) expires on December 31, 2016. The changes in the Notice, subject to modification, will be finalized in a revenue procedure later this year and will apply to QI Agreements in effect on or after January 1, 2017. The main changes set forth in the Proposed QI Agreement are discussed in detail below.

Application Eligibility & Process

Certain foreign persons are eligible to enter into a QI Agreement including Foreign Financial Institutions (FFIs), foreign branches of US financial institutions and US clearing organizations, foreign clearing organizations, and certain Nonfinancial Foreign Entities (NFFEs). Territory Financial Institutions and Nonparticipating FFIs may not apply to enter into a QI Agreement. Additional eligibility requirements depend on the foreign person's status, such as compliance with the FFI Agreement for a participating FFI. Certain entities may enter into the QI Agreement for the sole purpose of participating in the QDD regime.

A prospective QI (other than certain NFFEs and foreign central banks of issue) must have submitted a Form 8957 and obtained its chapter 4 status as a Participating FFI, Registered Deemed-Compliant FFI, Registered Deemed-Compliant Model 1 IGA FFI, Direct Reporting NFFE, or Sponsoring Entity of a Direct Reporting NFFE as well as a global intermediary identification number ("GIIN"). To become a QI, a prospective QI must then submit Form 14345, *Application for Qualified Intermediary, Withholding Foreign Partnership, or Withholding Foreign Trust Status,* to establish that adequate resources and procedures exist to comply with the QI Agreement. If the QI application is approved, the IRS will provide an approval notice and QI-EIN.

An existing QI must renew its QI Agreement through the FATCA registration website if it is an FFI, Direct Reporting NFFE, or Sponsoring Entity of a Direct Reporting NFFE. If an existing QI is an NFFE that is not acting as a QI on behalf of its shareholders and is not a Sponsoring Entity, it must renew its QI Agreement by submitting a renewal request to the Foreign

Intermediaries Program. If an existing QI also seeks to act as a QDD, it must provide a supplementary statement containing all QDD-related information required by Form 14345. All renewals must take place prior to March 1, 2017.

New QI Agreements will be effective for a period of three years and would become effective if approved, as follows:

- If entered into on or before March 1st, on January 1st of the same year.
- If entered into after March 1st and the applicant has not yet received any reportable payments, on January 1st of the same year.
- If entered into after March 1st and the applicant has received reportable payments, the 1st of the month in which it is approved.

The Notice and Proposed QI Agreement changes the policy of issuing QI Agreements retroactively to the first day of the year regardless of when they are entered into.

Special rule for NFFEs

Although an FFI must be located in a country that has IRS approved "Know your Customer" procedures, NFFEs are not required to be located in approved jurisdictions as they cannot rely on documentary evidence.

Beneficial Owner's Claim for Treaty Benefits

Treasury and the IRS are expected to modify the chapter 3 regulations to require withholding agents to collect certain information and certifications regarding a beneficial owner's claim for treaty benefits. In line with this, Form W-8BEN-E released in April 2016 was revised to include beneficial owner certifications relating to the Limitation on Benefits (LOB) provision of an applicable treaty. Similarly, Form 1042-S was revised to include a line to report the corresponding LOB code.

As such, the Proposed QI Agreement requires a QI to collect LOB information from entities in order to support the account holder's treaty claim (i.e., revised Form W-8BEN-E or documentary evidence and a treaty statement). A QI that uses documentary evidence to document an entity account holder claiming a reduced rate of withholding under an income tax treaty must collect a separate statement from the claimant including the more detailed LOB information. The timeframes for collecting this information depend on the account's status:

- If the QI opens an account or obtains documentation for an entity account holder on or after January 1, 2017, the QI must collect the new LOB information.
- If the account is a pre-existing account that was documented with documentary evidence, the QI must collect LOB information prior to January 1, 2019 (unless there is a change in circumstances requiring the QI to obtain corrected information before this date).
- If the account is a pre-existing account that was documented with a Form W-8, the form may be relied upon until its normal expiration period (unless there is a change in circumstances requiring the QI to obtain corrected information before this date).

Standard of Knowledge

Under the Proposed QI Agreement, QIs are subject to an actual knowledge standard with respect to LOB claims. In addition, with respect to validation of treaty claims, a QI has reason to know that a treaty claim is unreliable or incorrect if the account holder (both individuals and entities) claims benefits under a treaty that does not exist or is not in force and is, thus, not included on the online list of income tax treaties maintained by the IRS. Application of this rule depends on the account's status:

- For pre-existing accounts for which the QI already holds valid documentation, this rule generally only applies upon a change in circumstances.
- For pre-existing entity accounts, the rule also applies when a QI obtains the required written LOB statement.
- For all new accounts, the rule applies upon account opening.

As written, the new reason to know standard would not appear to apply to pre-existing accounts that were documented with a Form W-8BEN-E unless there was a change in circumstances.

The chapter 3 regulations will be amended to apply both standards of knowledge for LOB claims.

Compliance Procedures

Certification of Internal Controls

A QI's responsible officer (RO) must undertake a periodic review and make a periodic certification of internal controls. Responding to concerns raised about the impact of the compliance review procedures contained in the 2014 Agreement on the QI, the Proposed QI Agreement allows an RO to rely on reasonable procedures, processes, or reviews in addition to the results of the periodic review in order to make such certifications of compliance. Accordingly, the RO can decide whether to use an external or internal reviewer and what the scope of the engagement should be. In making the certification, the RO must document what he or she has relied upon and retain such documentation for the same period of time for which the compliance review report and certifications must be retained (i.e., as long as the QI Agreement is in effect).

Timing

A QI must make the certification on or before July 1 of the calendar year following the certification period. The initial certification period is the period ending on the third full calendar year that the 2014 QI Agreement and any superseding revenue procedure were in effect. Thus, a QI with a QI Agreement with an effective date of June 30, 2014 must treat the initial certification period as ending on December 31, 2017 and will be required to make a certification on or before July 1, 2018 (pursuant to the requirements of the QI Agreement in effect after December 31, 2016). A QI that had a QI Agreement under old Rev. Proc. 2000-12 in effect prior to June 30, 2014 with an audit cycle that would have extended past such date, is not required to complete an audit under the previous QI Agreement.

Periodic Review

In addition to making the certification of internal controls, a QI must also report certain factual information regarding its documentation, withholding, reporting, and QDD tax liability (if applicable) obligations under the QI Agreement. Some of this information is gathered through testing of accounts and transactions as part of a periodic review. The IRS clarified that the periodic review does not need to satisfy the standards of a financial audit or other attestation engagement by replacing the term “auditor” with “reviewer” and specifying that the RO can arrange for the review to be conducted by an internal or external reviewer so long as there is sufficient independence to objectively conduct the review, meaning that a reviewer, whether external or internal cannot review their own work. Moreover, in order to provide QIs with flexibility in the review, the IRS will not publish a step-by-step audit plan and will instead expect each QI to create a step-by-step plan to satisfy the review objectives.

Sampling Methodology

Responding to requests for a safe harbor method for determining a sample of accounts for the periodic review, the Proposed QI Agreement provides a stratified statistical sampling methodology. A QI with 50 or more accounts must review at least 50 accounts and may use a sample to test accounts while a QI with fewer than 50 accounts must review all accounts and may not use a sample. Although the review is not required to include statistical sampling procedures for testing transactions, the reviewer must record its sampling methodology and be able to reconstruct the sample.

Waiver

In certain circumstances, QIs may apply for a waiver of the periodic review requirement but if granted will still be required to provide some factual information along with the periodic certification. To be eligible to apply for a waiver, (1) the QI must not also act as a QDD, (2) the QI must not be part of a consolidated compliance program, (3) for each calendar year covered by the certification period, reportable amounts received by the QI must not exceed $5 million, (4) the QI must have timely filed Forms 1042, 1042-S, 945, 1099, and 8966 for all calendar years covered by the certification period, and (5) the QI must have made all periodic certifications and reviews under sections 10.02 and 10.03 of the Proposed QI Agreement as well as any certifications required pursuant to FATCA, and (6) the QI must have made its certification of effective internal controls.

A QI must apply for a waiver for each certification period for which the waiver is requested and must request the waiver at the time the RO makes the periodic certification of internal controls. If the IRS does not approve the waiver, the QI will receive a six-month extension from the date of denial to complete its periodic review.

Timing

Responding to comments regarding difficulties with conducting the periodic review during the last year of the certification period (e.g., resource constraints due to all QIs conducting periodic reviews at the same time), the Proposed QI Agreement allows QIs to choose which year in the certification period to select for the periodic review. However, if a QI is also acting as QDD, it must use 2017 for its periodic review for the initial certification period.

Qualified Derivatives Dealer (QDD)

The Proposed QI Agreement includes new implementing provisions announced in Temporary and Proposed regulations issued in September 2015 allowing certain QIs to act as QDDs subject to specific requirements and obligations. A separate Tax Alert providing more detail on the QDD provisions will be issued to supplement the brief overview, below.

Requirements and Scope

The QDD provisions apply only to an eligible entity that elects QDD status, and only with respect to transactions in which the QI acts in a dealer capacity as a principal to its counterparty and the transactions give rise to US source dividends and potential dividend equivalent payments under section 871(m) or would give rise to such income if received by a foreign entity instead of a foreign branch of a US financial institution. In addition, amounts paid by a QDD must be potential dividend equivalent payments under section 871(m) or would be potential dividend equivalent payments but for the fact the counterparty is a domestic person or a foreign person who receives the payments as effectively connected income with a trade or business within the United States. Transactions entered into for proprietary trading or investment purposes do not qualify for the QDD regime. However, transactions recorded in a dealer book are presumed to be entered into in dealer capacity for purposes of the QDD rules.

Eligible entity

To qualify as a QDD, an entity must be an "eligible entity" and enter into a QI Agreement. Eligible entities include certain (1) government-regulated securities dealers, (2) government-regulated banks that issue potential section 871(m) transactions to customers and receive dividends or dividend equivalent payments pursuant to such transactions to hedge those transactions issued to customers, and (3) entities wholly-owned by an entity described under (2). A foreign branch of a US financial institution is an eligible entity if it would fall under one of the above categories if it were a foreign separate entity. The definition of dealer is determined under section 475(c)(1).

Observation

The foreign entity may qualify as an eligible dealer in securities for QDD purposes without qualifying as an eligible regular dealer in securities for purposes of the Subpart F and global securities dealing rules. The rules permitting exemption from withholding are more permissive than they are for Subpart F exemption and single-enterprise transfer pricing and risk-transfer agreement qualification purposes.

For all such eligible entities, as announced in Temporary and Proposed Regs. §1.871-15(p) and 1.1441-1(e)(6) and its preamble, the Proposed QI Agreement adopts the principles of the Qualified Securities Lender ("QSL") regime provided in Notice 2010-46 with respect to all US source dividends received as beneficial owner and all dividend equivalent payments received as principal counterparty under section 871(m) or which would be dividend equivalent payments received but for the fact they are received by a foreign branch of a US financial institution. All persons who elected QSL treatment pursuant to Notice 2010-46 outside the QI regime and who currently obtain exemption from US withholding on US source substitute dividend payments with respect to stock lending and stock sale repurchase transactions defined in Treas. Regs §1.861-3(a)(6), will only be able to continue such exempt treatment as an electing QDD and only within the QI program. The QSL program for persons acting outside the QI regime is being phased out for all substitute dividend payments as of January 1, 2017.

Phase-out of Credit Forward treatment

The "credit forward" regime provided in Notice 2010-46 for entities that do not elect the QSL regime is being phased out for substitute dividend payments after December 31, 2016. Accordingly, US source substitute dividend payments that are not paid to an eligible QDD after December 31, 2016 will be subject to potential cascading of US gross basis tax for payments made in a chain of transactions to foreign persons. The credit forward regime could still be restored when the temporary regulations are finalized, but, such relief has not been provided by the Notice. The Notice states that non-QSLs may continue to use the credit forward regime until the Proposed QI Agreement becomes effective.

QDD regime expands scope of eligible transactions

In addition to substitute dividend payments defined in Treas. Reg. §1.861-3(a)(6), and characterized as dividends under Treas. Regs §1.871-7(a)(6) and §1.881-2(b)(2), the QDD regime also applies to all other dividend equivalent payments determined under section 871(m) with respect to Equity Linked Instruments (ELIs) that the QSL regime does not apply to.

Segregation of principal and intermediary transactions

A QI acting as a QDD is generally required to act as a QDD for (1) all payments with respect to potential section 871(m) transactions and underlying securities that it receives as a principal and (2) all payments with respect to potential section 871(m) transactions that it makes as a principal. However, a QI may not act as a QDD when it receives or makes a payment with respect to a potential section 871(m) transaction as an intermediary. For such payments, the QI may either act as a QI or a nonqualified intermediary (NQI).

Reporting and Withholding Responsibilities
A QI acting as a QDD must assume primary responsibility for chapters 3 and 4 withholding, Form 1099 reporting, and section 3406 backup withholding for all payments made with respect to potential section 871(m) transactions as a principal, including payments that are not dividend equivalent payments but are either subject to chapter 3 or 4 withholding or are reportable payments. For Form 1042-S purposes, a QDD must perform specific payee reporting for payments of amounts subject to chapter 3 withholding to other QDDs.

QDD Tax Liability
A QDD (other than a foreign branch of a US financial institution) must determine and pay its "QDD tax liability," which is the sum of the QDD's liability under sections 871(a) and 881 for (1) its newly defined "section 871(m) amount," (2) its dividends that are not on underlying securities associated with potential section 871(m) transaction and its dividend equivalent payments received as a QDD in its non-dealer capacity, and (3) any other US source FDAP payments received as a QDD with respect to potential section 871(m) transactions or underlying securities that are not dividend or dividend equivalent payments. A QDD must report its QDD tax liability on Form 1042 and make any necessary payments and deposits with respect to such amount.

Section 871(m) amount
The QDD's "section 871(m) amount" is the excess of its dividends and dividend equivalent payments received in dealer capacity over the sum of the amount of dividend equivalent payments made in its dealer capacity and the amount of dividend equivalent payments the QDD is contractually obligated to make acting as a QDD in dealer capacity. Offsetting payments also include payments made to persons that would be dividend equivalent payments but for the fact they are paid to a US non-exempt person or that is effectively connected income to a foreign person.

Observation
In determining the section 871(m) amount, gross dividends with respect to stocks beneficially owned by a foreign entity acting as QDD are eligible for offset by dividend equivalent payments made by the QDD acting in its dealer capacity. Accordingly, the QDD regime enables gross basis tax and withholding exemption on US source dividends where the current QSL regime does not.

Offsetting dividend equivalent payments made by the QDD in dealer capacity remains subject to withholding to the extent the foreign counterparty is subject to gross basis tax as a documented or undocumented foreign beneficial owner.

Account for Section 871(m) Transactions
The Proposed QI Agreement specifically defines "account" with respect to a QI acting as a QDD to include any potential section 871(m) transactions or underlying securities where the QI receives payments as a principal and any potential section 871(m) transactions where the QI makes payments as a principal. A QI acting as a QDD is not required to document each account. Instead, a QDD is only required to document an account holder of an account to which it makes a reportable payment or qualifying dividend equivalent offsetting payment.

Consistent Treatment of All Eligible QDD Transactions
The Proposed QI Agreement requires an eligible electing QDD to act as QDD for all securities lending and sale-repurchase transactions that are 871(m) transactions in addition to acting as QDD for payments with respect to other potential 871(m) transactions and underlying securities as a principal. All such transactions that a QI enters into will be deemed to be entered into by the QI as a principal and, thus, within the QDD regime, unless they are not entered into in dealer capacity. All non-dealer transactions (i.e. that are not presumed entered into in dealer capacity) must be segregated and not taken into account in determining the section 871(m) amount even if such transactions are subject to dividend equivalent treatment under section 871(m).

Coordination with Section 871(m) Regulations
Treasury and the IRS intend to modify the 871(m) regulations in accordance with the provisions of the Proposed QI Agreement with respect to QDD requirements and withholding agents making payments to QDDs.

France:

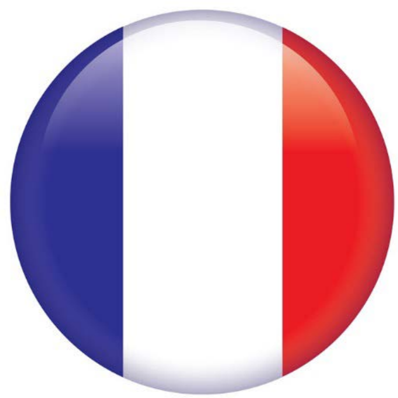
Panama re-added to list of noncooperative jurisdictions

On April 8, 2016, the French tax authorities reclassified Panama as a "noncooperative" country for purposes of France's list of noncooperative states or territories (NCSTs). Panama was removed from the list in 2012 following the conclusion of a tax treaty with France, but has been added back to the list as from January 1, 2016, because France did not consider that the exchange of information provision in the treaty was operating as it should.

An NCST is a jurisdiction that is not an EU member state and has not concluded a treaty with France (or with at least 12 other jurisdictions) that includes an administrative assistance provision regarding tax matters. A jurisdiction that has signed such an agreement with France still may be considered an NCST if the treaty is not ratified or if the administrative assistance provision is not effectively applied by the other contracting state.

Inclusion on the NCST list means that dividends, interest and royalties paid out of France to the NCST jurisdiction will be subject to a 75% withholding tax, and dividends received from entities located in the NCST jurisdiction and capital gains on the disposal of shares in companies located in the NCST jurisdiction may not benefit from the French participation exemption. (However, as provided in the amended finance law for 2015, the participation exemption for dividends will apply if the French recipient company can demonstrate that the distributing entity carries on real activities and that the location of the entity does not aim at, or result in, the entity benefiting from a favorable tax regime in the NCST.) The measures increasing the tax burden on payments from/to NCSTs will apply with respect to payments between France and Panama as from January 1, 2017.

The French government publishes the list of NCSTs on an annual basis. The list now includes seven jurisdictions: Botswana, Brunei, Guatemala, Marshall Islands, Nauru, Niue, and Panama.



Australia:

Australia's tax authorities target cross-border profit-shifting arrangements

The Australian Taxation Office (ATO) released four taxpayer alerts on April 26, 2016, that identify certain issues of concern to the ATO, as a result of the active review of certain arrangements used by multinationals and large companies operating in Australia. The ATO wants to ensure these companies pay the "right amount of tax" on income earned in Australia.

A taxpayer alert provides a summary of ATO concerns about a significant, emerging or recurring higher-risk tax issue. The alerts are intended to provide an "early warning" to taxpayers and advisers that a type of arrangement may be subject to increased scrutiny or the subject of further guidance from the ATO.

The four taxpayer alerts address the following:

- Interim arrangements in response to the Multinational Anti-Avoidance Law (MAAL);
- Inappropriate recognition of internally generated intangible assets and revaluation of intangible assets for thin capitalization purposes;
- Arrangements involving related party foreign currency-denominated financing, in conjunction with related party cross-currency interest rate swaps; and
- Cross-border leasing arrangements involving mobile assets.

A summary of the ATO alerts follows.

Multinational Anti-Avoidance Law

The MAAL was enacted with effect from 1 January 2016, to broadly target certain cases where there has been an avoidance of permanent establishment (PE) status by a foreign entity, the foreign entity makes supplies to Australian customers and there is a relevant "principal purpose" to obtain a tax advantage.

Some taxpayers are restructuring into MAAL-compliant arrangements, and the ATO has raised concerns about two particular forms of arrangement that it sees as being "artificial and contrived," rather than "commercially and economically realistic":

- Offshore agent for Australian entity: One scheme involves the foreign and Australian entities "swapping their roles via contracts" that purport to make the Australian entity the distributor of the products or services to Australian customers. The foreign entity acts as an agent (disclosed or undisclosed) of the Australian entity, collecting the sales revenue from Australian customers on behalf of the Australian entity. The arrangement purports to result in no supply being made by the foreign entity and, potentially, in the foreign entity becoming a PE of the Australian entity in the foreign entity's jurisdiction. The ATO is concerned where this type of contractual arrangement occurs despite no changes being made to the underlying functions performed by the entities.
- Royalty payment restructured to a distribution fee: The other arrangement deals with upstream aspects of the supply chain. Where a foreign entity makes supplies to Australian customers and pays a royalty connected to such transactions, the application of the MAAL may result in the royalty being subject to Australian withholding tax. The ATO is concerned by some restructurings of the arrangements, under which the royalty is recharacterized as a distribution fee that arguably is not subject to Australian withholding tax.

The ATO indicates that it has a range of potential concerns regarding both types of arrangements, including that the arrangements may not be legally effective or commercially viable. A range of measures could potentially be applied to challenge the arrangements, including the general anti-avoidance rule (GAAR) and the transfer pricing rules. The ATO states that taxpayers and advisors that put forward these types of arrangements will be subject to increased scrutiny.

Financing arrangements

Two of the four taxpayer alerts address financing arrangements – one deals with the Australian thin capitalization rules and the other with related party foreign currency loans, in conjunction with related party cross-currency interest rate swaps.

Thin capitalization: Australia's thin capitalization rules permit a general safe harbor debt amount of up to 75% of the value of a taxpayer's Australian assets (net of nondebt liabilities) before interest deduction limitations will apply. The relevant asset values typically are taken from a taxpayer's financial statements. However, the thin capitalization provisions permit taxpayers to recognize and/or revalue certain intangible assets in circumstances where the asset would not otherwise qualify for recognition/revaluation under the applicable accounting standards. In both cases, the result is that the asset value can be increased, thus increasing the thin capitalization safe harbor amount.

The ATO indicates that it has a number of concerns with these provisions, including that certain items that are being recognized fall outside the scope of the intangible asset recognition criteria under the applicable accounting standards. Based on its compliance activities, the ATO is concerned by the recognition of items such as the following:

- Market-related items, such as "customer relationships" or "customer loyalty";
- Human resource items, including "skilled staff," "management" or "key employees/training";
- Organizational resource items, including "internal policies," "internal meeting protocols," "procedures" and "manuals"; and
- Assets not owned and controlled by the taxpayer.

The ATO also is concerned that taxpayers may be applying unsupportable or questionable assumptions to support their revaluations.

The ATO has obtained external advice on the application of relevant accounting standards, and is considering its ability to substitute alternative asset valuations. Further accounting and legal guidance is expected from the ATO.

Related party cross-currency interest rate swaps: The taxpayer alert outlines the following arrangement as an area of focus:

- An Australian entity borrows from offshore in a "low interest rate currency" (a currency other than AUD);
- The Australian entity enters into a swap or other derivative arrangement with an offshore related party, under which the Australian entity is required to pay amounts in a "higher interest rate currency" (e.g. AUD) and is entitled to receive payments in the foreign currency in which the loan is denominated; and
- Where there is a net payment by the Australian entity under the swap or other derivative, these payments represent additional financing costs that are not in the legal form of interest.

The ATO notes that some taxpayers assert that these arrangements have been entered into for accounting or ease of capital extraction purposes.

The ATO is concerned that these arrangements achieve artificial thin capitalization, withholding tax and transfer pricing outcomes. In particular, the ATO observes that the funding may have been implemented in an excessively complex manner for Australian tax purposes, rather than in a simpler manner more appropriate in the circumstances (such as funding by AUD loans, foreign currency loans (without swaps) or equity-inclusive funding).

The ATO considers that such arrangements may be open to challenge, including whether the swap/derivative payments are deductible, whether the transfer pricing rules may operate to adjust the tax outcomes and whether the GAAR may apply. The ATO is expected to issue further details as it continues to develop and refine its technical position.

Cross-border leasing involving mobile assets

The ATO will focus on lease-in, lease-out (LILO) arrangements involving the following circumstances:

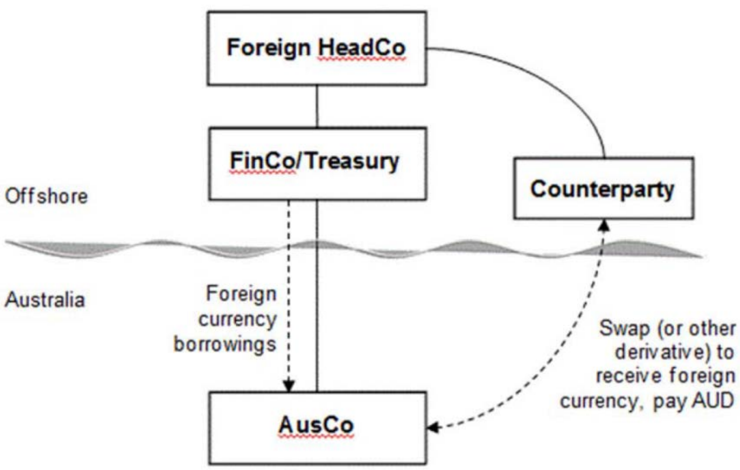
- A foreign head lessor owns substantial equipment and leases it to a related foreign party (the sub-lessor), who subleases the asset to a related Australian party (the sublessee);
- The Australian sub-lessee provides services to an Australian customer; and
- The sub-lessor has a PE in Australia under the relevant tax treaty.

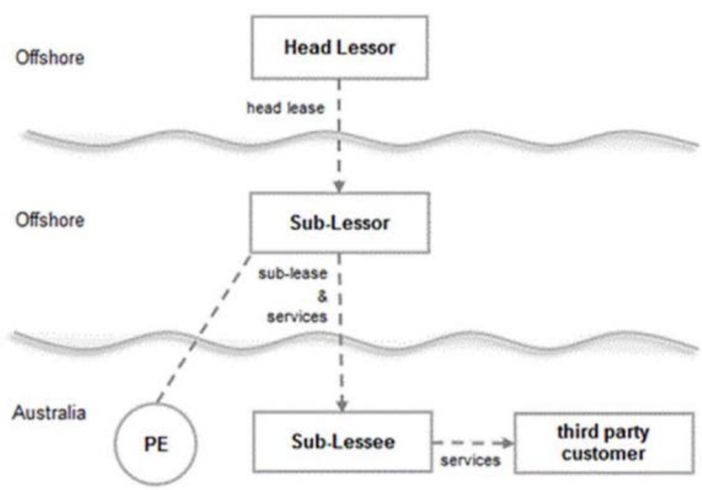
An example of a LILO arrangement is depicted below.

The ATO is concerned that the sub-lessor may have been introduced into the arrangement to obtain favorable benefits under a tax treaty that may be subject to challenge under the GAAR, and whether the transfer pricing rules are being appropriately applied to achieve an arm's length return to the Australian tax system. The ATO is expected to issue guidance on transfer pricing and profit attribution issues associated with certain cross-border leasing arrangements.

Comments

The taxpayer alerts reflect the ATO's general views in connection with arrangements that necessarily involve complex facts and complicated areas of the tax law. However, the ATO has clearly identified such arrangements as significant, emerging or recurring higher-risk tax issues. Taxpayers that have entered into these or similar arrangements should contact a tax adviser.





Luxembourg:

The Reserved Alternative Investment Fund (RAIF) – A new and innovative vehicle to host alternative investment funds in Luxembourg and other legislative modernizations

On July 14, 2016, the Luxembourg parliament voted on a law regarding the Reserved Alternative Investment Fund (Fonds d'Investissements Alternatifs Réservés - RAIF). This law, along with the law voted yesterday on the modernization of the law of August 10, 1915 on commercial companies as amended (the "Company Law"), both offer an attractive legal framework for different investors looking to structure their investments through Luxembourg.

The Reserved Alternative Investment Fund (RAIF): the perfect tool for alternative investments players

The RAIF regime will significantly widen the options for Private Equity, Real Estate, or Hedge Funds managers in Luxembourg.

The new RAIF regime proposes to provide all the existing benefits associated to the specialized investment fund (SIF) or Société d'investissement à capital variable (SICAR) regimes in a pragmatic legal environment. One of the key benefits of the RAIF regime for fund managers will be the absence of overlapping of regulations at the product and manager levels offering unique go-to-market capabilities compared to offshore fund regimes or other existing onshore fund regimes.

We are confident that such a fund regime will provide an efficient and consolidated answer to many of the challenges fund managers are facing in the current environment.

A flexible and dynamic legal framework

The RAIF can be set-up within a very short timeframe and will be largely modelled on the popular SIF regime. It will not be subject to the approval and/or supervision of the Luxembourg regulatory authority and will benefit from the structuring flexibility also applied to the other types of Luxembourg investment funds and SICAR.

The RAIF will be managed by an authorized AIFM and as such will be indirectly subject to the AIFMD regime. The AIFM regulation will be fully applicable with the related investor protection and this new fund will benefit from the marketing passport granted to the AIFM allowing to strengthen the position of Luxembourg as a primary platform to distribute fund products.

The RAIF should be able to adopt any fund strategy, invest in any asset class and, under certain conditions, not be required to diversify its portfolio of assets.

A tax neutral vehicle benefiting from the tax regime applicable to other funds with some particularities

The main objective of this new regime is to propose a tax neutral vehicle to investors allowing fund managers to accommodate various investments and/or investors' tax needs or constraints.

The applicable tax regime will solely depend on how the fund is set up.

A RAIF vehicle relying on the SIF tax regime will be exempt from corporate income tax, municipal business tax and net worth tax. There will not be withholding taxes on distributions or any tax on speculative capital gains for investors. A 1 bps subscription tax, with exemptions available similarly to a SIF, will be applied.

If the RAIF invests in risk capital benefits, then it may be subject, like a SICAR, to corporate income tax and municipal business tax, although not to net wealth tax (except for the minimum net wealth tax). However, any income from transferable securities and income from temporary investments (investments made for less than 12 months) will be exempt. Again, there will be no withholding taxes on distributions or any tax on speculative capital gains for investors.

In both cases, it will be possible to set-up the fund as a tax transparent vehicle, whether this is as a mutual fund in the case of a RAIF-SIF or as a partnership for RAIF-SIF and RAIF-SICAR.

VAT is generally also a key factor when deciding upon the location of the fund, especially in comparison to offshore funds. The fees paid in consideration for the management of the fund vehicle should in principle be eligible to the Luxembourg VAT exemption whether the RAIF opts for the SIF or the SICAR tax regime.

Other legislative modernizations: the amended Company Law

The modernization of the Company Law confirms pre-existing practices and respects the contractual freedom of shareholders as well as legal certainty regarding third parties.

This modernization seeks to relax the regime involving shares without voting rights of public limited companies (sociétés anonymes – S.A.), allowing for the preservation of the rights of shareholders looking to only hold economic rights in a company. This company could also issue shares below the par value or even with unequal values.

The rules relating to functioning of a private limited liability company (société à responsabilité limitée - S.à r.l.) have also been subject to important structural modifications. Such changes include, among others, the increase of the maximum number of shareholders from 40 to 100, confirmation of the ability to issue tracking shares, as well as the possibility to include an authorized share capital clause allowing the board of managers to increase the share capital subject to certain limitations. Last but not least, a S.à r.l. could issue both redeemable as well as profit shares (parts bénéficiaires) with or without voting rights, providing greater flexibility for investors.

Further to this modernization, the S.à r.l. is beginning to resemble to an SA in certain aspects.

A new form of company (société par actions simplifiée) has been introduced in the amended Company Law which is mainly based on the same rules which govern the public limited liability company (S.A.) and is characterized by a greater contractual freedom.

Contacts:

For additional information or questions regarding international tax developments, please visit http://www.deloitte.com or contact one of the following tax leaders:

Julia Cloud
National Managing Partner, Investment Management Tax Practice
Deloitte Tax LLP
Tel: +1 312 486 9815
Email: jucloud@deloitte.com

Ted Dougherty
National Managing Partner, Investment Management Tax Practice
Deloitte Tax LLP
Tel: +1 212 436 2165
Email: edwdougherty@deloitte.com

Thomas Butera
ITAMS Group Co-Leader
Principal, Deloitte Tax LLP
Tel: +1 212 436 3231
Email: tbutera@deloitte.com

Jimmy Man
ITAMS Group Co-Leader
Partner
Deloitte Tax LLP
+1 408 704 2674
Email: jman@deloitte.com