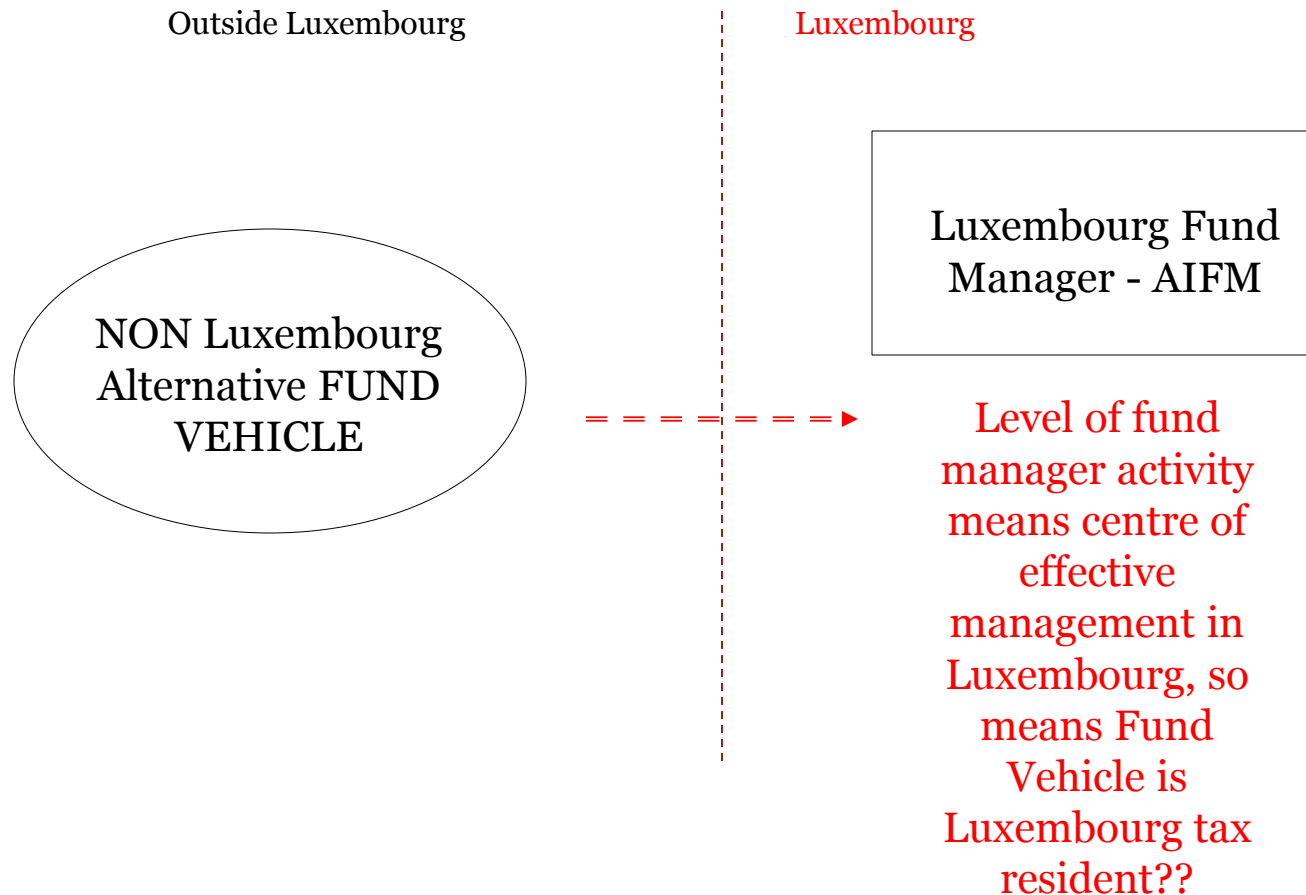


Tax Update

David Roach

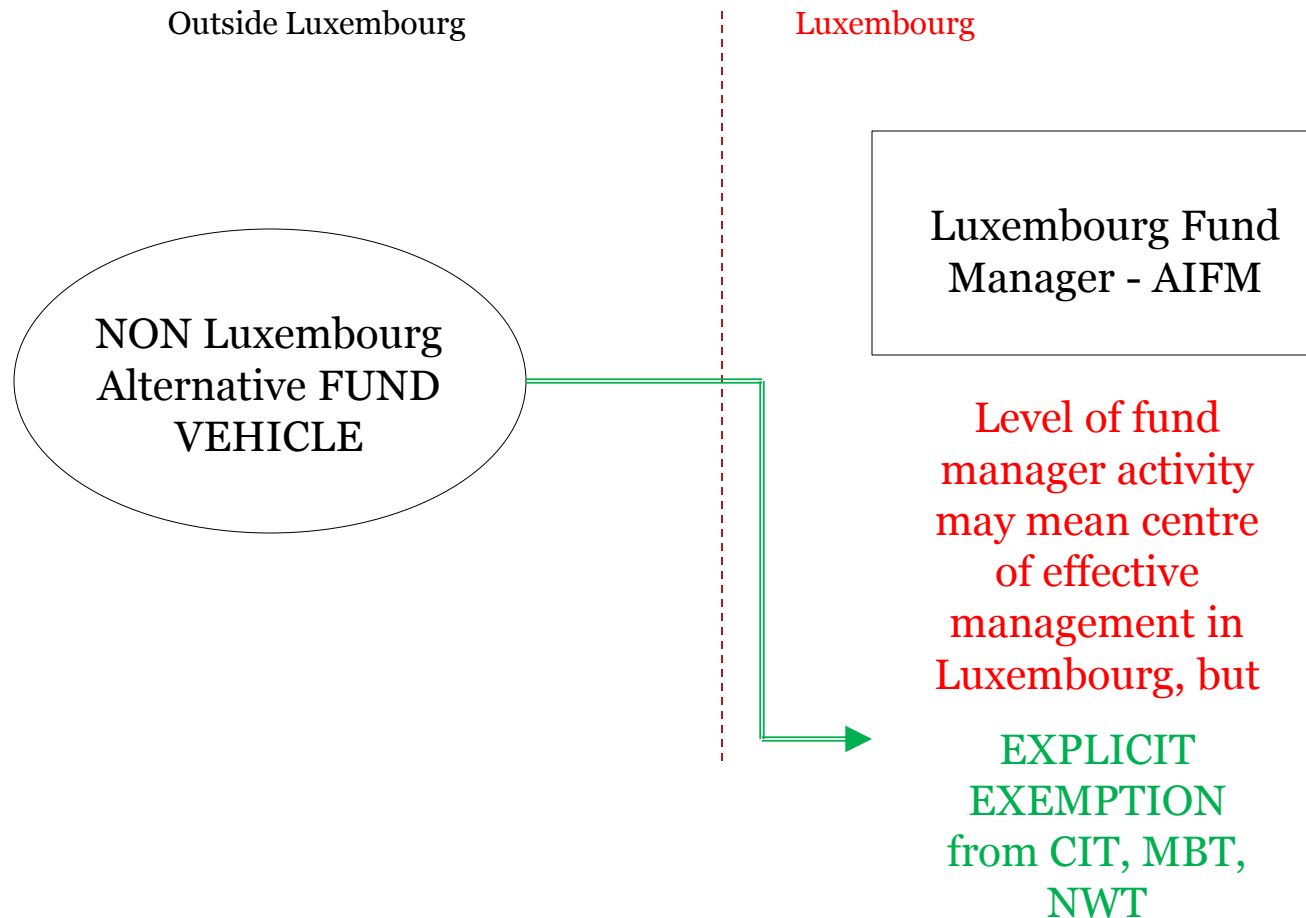
AIFMD Transposition – the tax “bonus”

Safety for non-Luxembourg Alternative Funds (1)



AIFMD Transposition – the tax “bonus”

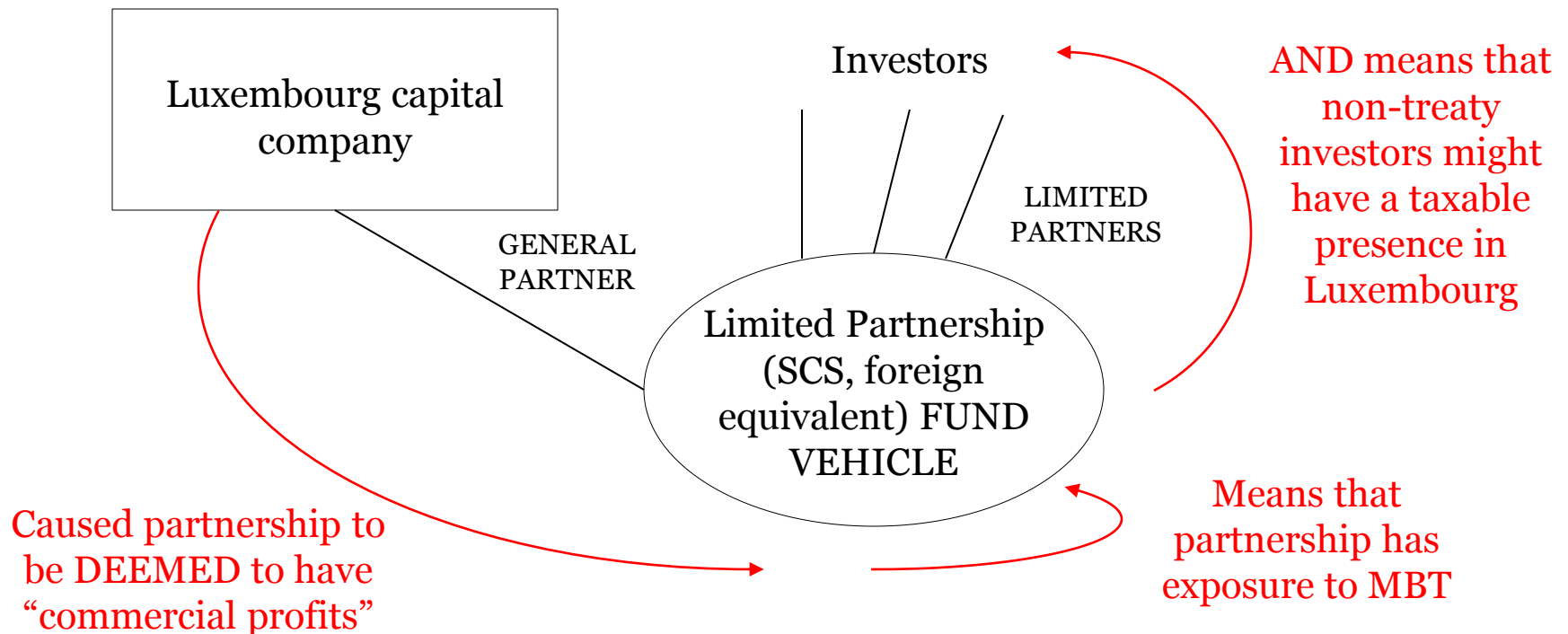
Safety for non-Luxembourg Alternative Funds (2)



AIFMD Transposition – the tax “bonus”

Limited partnerships - escaping the tax “taint” (1)

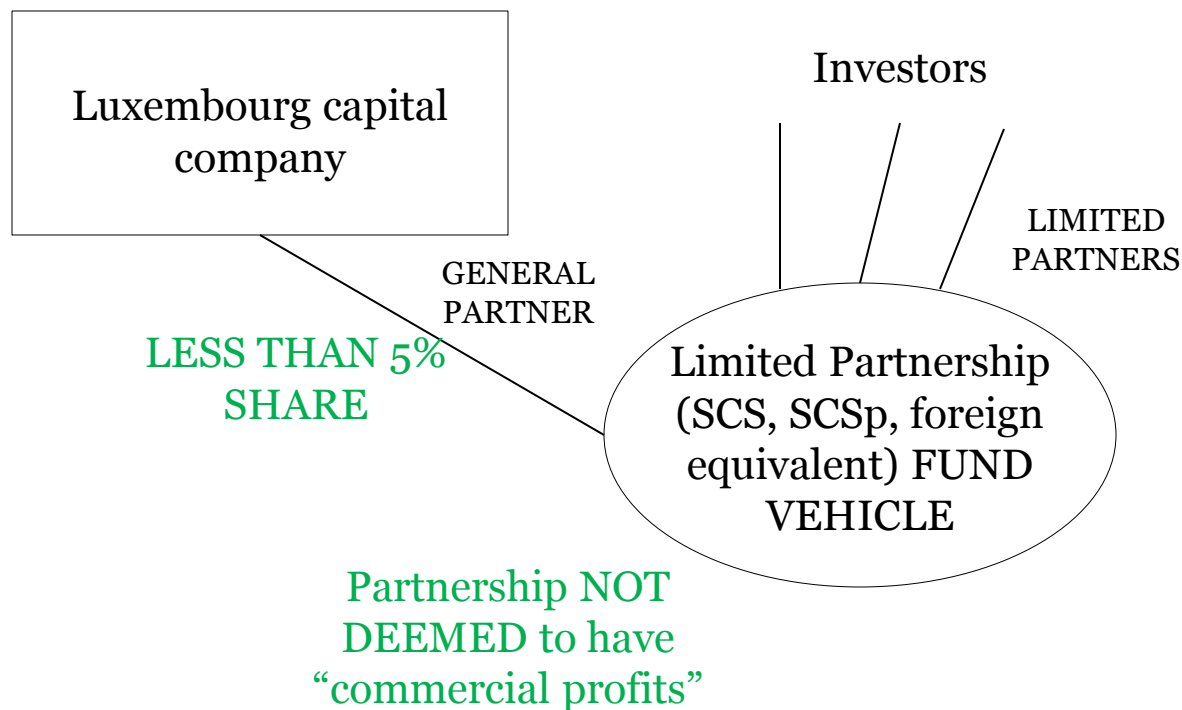
BEFORE JULY 2013



AIFMD Transposition – the tax “bonus”

Limited partnerships - escaping the tax “taint” (2)

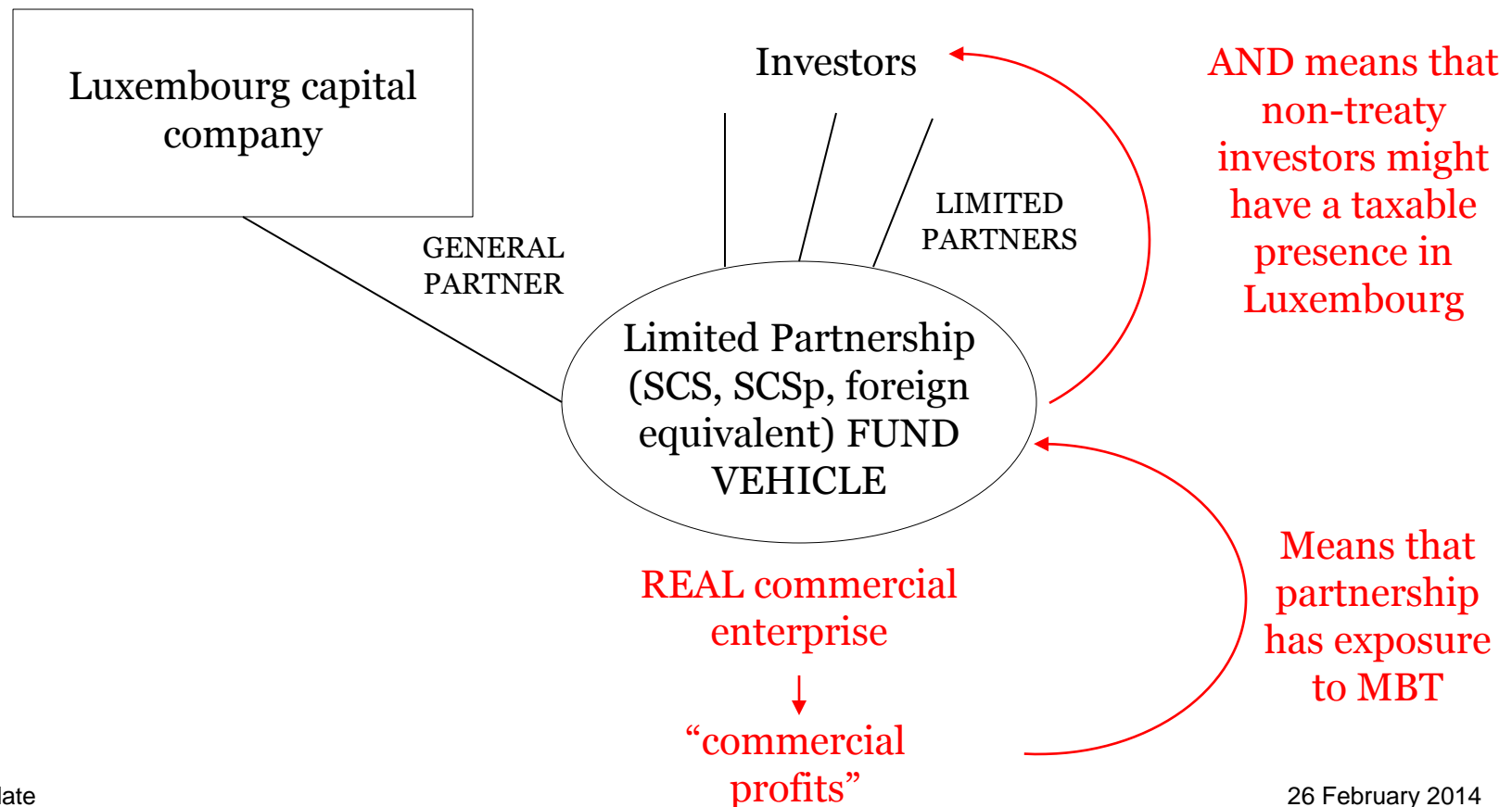
AFTER JULY 2013



AIFMD Transposition – the tax “bonus”

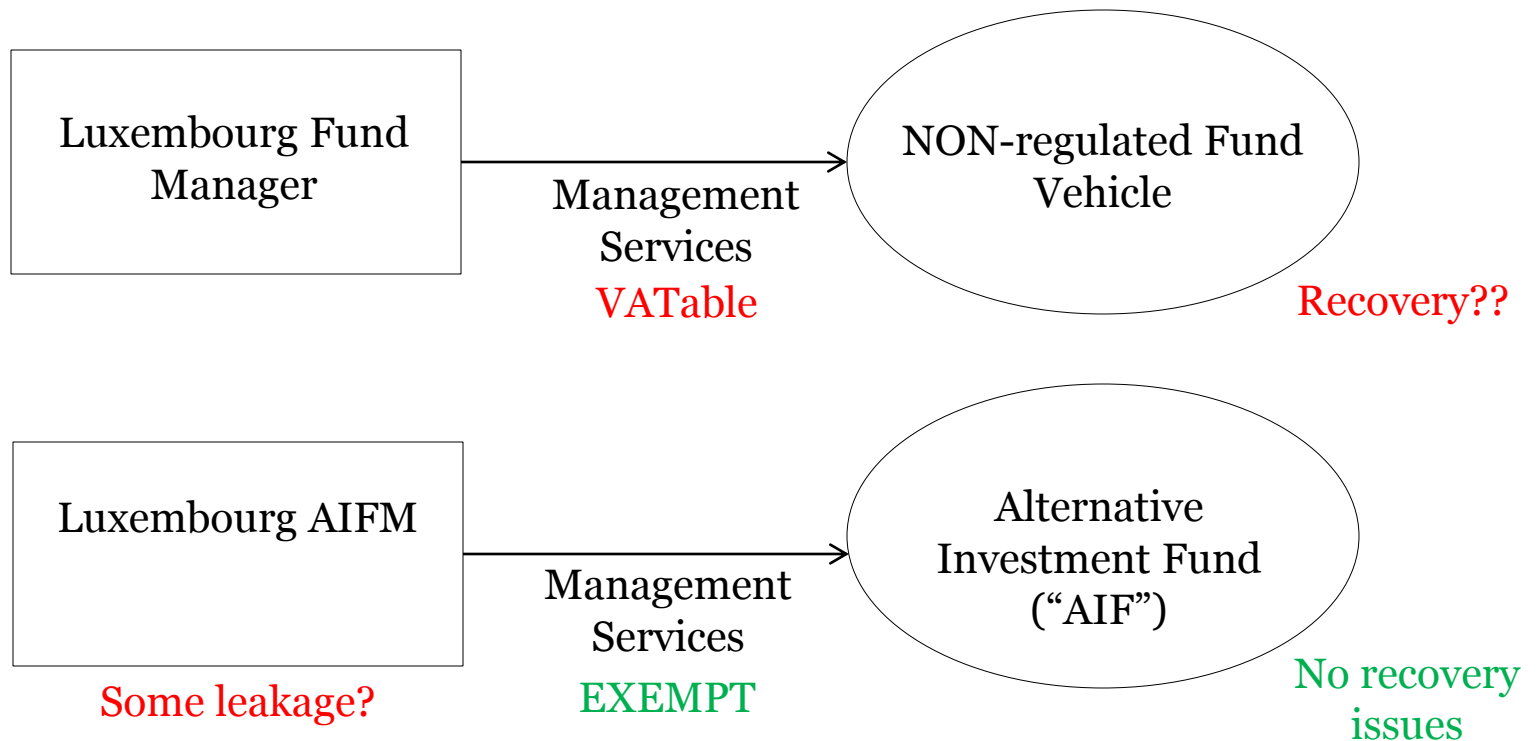
Limited partnerships - escaping the tax “taint” (3)

BUT STILL



AIFMD Transposition – the tax “bonus”

VAT



AIFMD Transposition – the tax “bonus”

Favourable tax treatment for “carried interest” (1)

- **What is covered?** Reward paid to individuals responsible for the performance of AIF investments, that is linked to growth in value (i.e. is based on the net assets of an AIF or its profits), not paid as salary *per se*, and paid out only when all capital commitments to investors have already been satisfied
- **How is it taxed?** Treated as speculative profits – normally at progressive rates (2014 – effective 43.6% top rate)
- **Special rules?** Taxed at 25% of effective rate otherwise applying, IF
 - Individual migrates to Luxembourg (and hasn’t already been subject to Luxembourg tax in the previous five tax years)
 - Individual hasn’t already received advances on the “carried interest”
 - The “carried interest” payment is made no later than ten years after the end of the year in which the individual migrates to Luxembourg

AIFMD Transposition – the tax “bonus”

Favourable tax treatment for “carried interest” (2)

- **What is covered?** Capital gains made by individuals responsible for the performance of AIF investments, which are linked to growth in value (i.e. is based on the net assets of an AIF or its profits) on shares or fund units issued by an AIF
- **How is it taxed?** Treated as speculative profits – normally at progressive rates (2014 – effective 43.6% top rate)
- **Special rules?** Completely tax exempt, so long as what is sold has been held for more than 6 months and isn't all or part of a holding of more than 10%

BEPS for Asset Management

BEPS in the public eye (1)

- A broad international initiative by the G-20, to address the perceived flaws in the international tax system that are said to be making tax planning too effective
- OECD asked to “take ownership” - its February 2013 report “Base Erosion and Profit Shifting” profiled the “BEPS” acronym. A 40 page Action Plan followed in July 2013 – 15 Actions, with 15 to 30 month timelines
- As the OECD is a “consensus” organisation, and fixing flaws will mean individual countries giving up long-standing features of their tax regimes, which either help “their” MNEs or encourage inward investment (competition for “mobile” tax profits), completion of the action plan by the OECD may take much longer than the 2 years intended, and involve many compromises
- But so far, the OECD are confident they will stick to their timetable

BEPS for Asset Management

BEPS in the public eye (2)

- Media focus on tax planning by major corporates (Apple, Google, etc.), plus lots of political momentum, means BEPS must be seen as “climate change”, rather than a short-term phenomenon
- The BEPS initiative is already causing some countries to take assertive unilateral action, introducing new laws to deal with issues (e.g. to deny deductions if the income is not taxed elsewhere)
- Many tax authorities, now emboldened by BEPS, are looking to increase challenges of taxpayers’ strategies
- Shareholders, group management and boards will increasingly ask those who manage a group’s tax about its current position and the potential impact of BEPS

BEPS for Asset Management

Which bits might bite (worst)?

	Mutual funds	Alternative Funds	Fund managers
4 Limit base erosion via interest deductions		Leverage of SPVs	
5 Counter harmful tax practices		Rulings	Rulings?
6 Prevent treaty abuses	WHT mitigation	WHT mitigation	WHT mitigation
7 Prevent artificial avoidance of PEs		Hedge fund traders?	Mobile employees, offshore lead managers
8-10 Transfer pricing to be in line with value creation			Brand value, sub-advisory fees
13 TP documentation – country by country reporting (CbCR)		Visibility of structures	Disclosure of global value chain

BEPS for Asset Management

The Action Plan - on Substance

“The involvement of third countries ... puts a strain on the existing rules, in particular when done via **shell companies** that have **little or no substance** in terms of office space, tangible assets and employees”

(Action Plan (Chapter 3), introductory text)

“The interposition of third countries in the bilateral framework ... has led to the development of ... **conduit companies** ... The rules must be modified to address the use of multiple layers of legal entities ... **Tight** treaty **anti-abuse** clauses ... will contribute to restore source taxation ...” (Action 6, supporting text)

The EU – feeling the “BEPS climate change”

The EU Commission view of BEPS

“The OECD is currently undertaking work on BEPS which is widely welcomed”

Explanatory Memorandum p2, EU Commission
Proposal amending P/S Directive, 25 November 2013

“The revision of the [Parent-Subsidiary Directive] can be an important contribution to the OECD BEPS work, as it would represent a best practice in fighting base erosion.”

EU Commission Memo – Q&A on the P/S Directive,
25 November 2013

- So, the 25 November 2013 proposals to amend the P/S Directive include as a principal component a “GAAR” – a General Anti-Abuse Rule - that would withdraw the benefits of the P/S Directive in the event of **artificial arrangements**

The EU – feeling the “BEPS climate change”

The P/S Directive GAAR amendment (1)

- More specifically, the draft Directive text targets
 - “... an artificial arrangement ... which has been put in place for the essential purpose of obtaining an **improper** tax advantage under this Directive, and which defeats the **object, spirit and purpose** of the tax provisions invoked.”
 - “... an artificial arrangement ... does **not reflect economic reality.**”
- Features of an arrangement that are indicative of artificiality include
 - “It being carried out in a manner which would **not ordinarily** be used in **reasonable business conduct**”; or
 - “It resulting in a **significant tax benefit** which is **not reflected in the business risks** undertaken by the taxpayer **or its cash flows**”

The EU – feeling the “BEPS climate change”

The P/S Directive GAAR amendment (2)

- There would be exposure under the P/S Directive GAAR (and any subsequent extension of it under EU law or jurisprudence) for **any** intermediate holding structure, UNLESS it could be asserted with confidence that the structure was NOT in place “*for the essential purpose of obtaining an improper tax advantage*”
- The big problem would be that, until ECJ have given clear judicial guidance as to where the line lies, one could not construe the subjective terms used in the GAAR (e.g. “*reasonable business conduct*”, “*not reflected in the business risks*” etc.) with any safety, and thus the GAAR has a “blunderbuss” effect
- This all might mean that **only** Luxembourg structures that have management **from Luxembourg** of a group of companies owned by the Luxembourg holding company (with the “shareholder activity” costs of management being borne there) would be GAAR-safe?

The EU – feeling the “BEPS climate change”

The P/S Directive GAAR amendment (3)

- The EU will have turned the “Substance” requirement
FROM
 - “*physically existing in terms of premises, staff and equipment*” - per Cadbury Schweppes ECJ case – **no need for a holding company or financing company to use large offices or employ a lot of staff**
- TO
 - having an economic “*raison d’être*” above and beyond just holding the participations – the **activity of the workforce needs to include managing the participations held**, not just performing functions not directly related to the participations
- **But will the EU Commission’s GAAR proposal in fact be adopted as drafted – if at all?**

And in Luxembourg?

Tax rulings

- In mid-September 2013 the FT ran a feature reporting that Ireland, the Netherlands and Luxembourg had been asked by the EU Commission to provide information about tax rulings - it's now understood that Belgium was also asked, and perhaps the UK, Gibraltar, Malta and Cyprus
- There is NO State Aid investigation - simply the possible opening step of an informal probe. As with similar EU Commission queries in the past, the request to Luxembourg was general in nature (no specific taxpayer or structure), and therefore does not form the basis of a formal investigation
- Luxembourg is still preparing a response (Luxemburger Wort, 7 February 2014)

And in Luxembourg?

The new Government's coalition programme (1)

- Corporate income tax rate should not be increased
- Municipal business tax – a general reform?
- VAT – rates to increase (by 2%) – but to remain the lowest standard rate in the EU
- Personal tax – recognition that Luxembourg must compete internationally and be able to attract highly qualified individuals
 - Improve “carried interest” regime
 - No reintroduction of net wealth tax for individuals
- Subscription tax (*taxe d’abonnement*) should not be increased – will look at reforms to improve competitiveness
- Stay OUT of the Financial Transaction Tax “enhanced cooperation” framework

• SICARs to stay – also further steps taken to attract major PE funds

And in Luxembourg?

The new Government's coalition programme (2)

- Emphatic support for the BEPS initiative, and BEPS-related tax proposals
 - Stricter rules for physical/operational substance
 - A more transparent rulings process, and augmented technical guidance from the tax authorities
 - A transfer pricing regime nearer the OECD “norm”, including much-expanded legislation, and tax authority resourcing
 - Support (under appropriate circumstances) for automatic exchange of information
- A “notional interest” deduction, linked to the capital base of a company
- Other steps to attract headquarters functions, e.g. functional currency rules formalised, group treasury cash pooling regimes

And in Luxembourg?

Exchange of information

- Luxembourg has had to react to OECD pressure on past failures on exchange of information – November 2013 Global Forum report had Luxembourg as “non-compliant” – but this did not consider post 2011 situation – a concern, as it deterred some institutional investors
- Latest position is that next OECD meeting should note substantial progress, and it is to be hoped that the November 2014 report will show “compliant” status
- As from 1 January 2015, Luxembourg will automatically exchange information on interest payments as covered by the existing EUSD
- Draft law 6632 published 17 December 2013 transposes the EU Directive on Mutual Administrative Assistance in Tax Matters (based on the OECD Convention)
- Luxembourg and Austria continue to resist signing up to extensions to the EUSD until “third countries” such as Switzerland also sign up

And in Luxembourg?

What next?

- Delayed 2014 state budget to be finalised for debate in Parliament in the week after Easter – we may have news of more concrete changes to the tax regime then
- Pierre Gramegna wants to progress cautiously – a tax reform is expected for the year 2016

Thank you

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