

Abstract

The world of taxation is changing on an international, European and national level. Impending reforms in the context of the OECD's BEPS initiative, new EU tax legislation, and shifting administrative and judicial approaches to domestic and cross-border fund structures will have a significant impact on funds, putting pressure on business and on national legislatures alike to stay ahead.

Luxembourg's regulatory and taxation framework for investment funds combines unique flexibility with legal certainty, making it Europe's leading centre for investment funds. In light of their paramount importance to Luxembourg's economy, this conference brings together academics and practitioners from Luxembourg, Europe and the US to share their expertise on questions arising from three different angles: national law and policy, European Union law, and international tax law.

Leading experts will give their insights on legal reforms in Luxembourg and Germany, the Commission's state aid practice, non-discrimination rules applied to funds taxation, the Anti-Tax-Avoidance Directive, tax treaty protection of different CIVs, VAT treatment of funds and fund managers, and the consequences of the global drive towards exchange of information on existing cross-border investment structures.

VENUE

Salle Tavenas
University of Luxembourg (Limpertsberg)

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Registration: <http://bit.ly/2epVjcV>
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□ FACULTY OF LAW, ECONOMICS AND FINANCE



INTERNATIONAL CONFERENCE

The Future of Funds Taxation

- Domestic Law,
Tax Treaties and
EU Law -

17 November 2016

Conference Programme

08:30 Registration

09:00 **Opening of the Conference**

- Stefan Braum (Dean, Faculty of Law, Economics and Finance)
- Werner Haslehner (University of Luxembourg)

Funds Taxation: National Law and Policy

09:10 - 09:30 **Introduction: Legal and Economic Nature of Funds**

Isabelle Riassetto (University of Luxembourg)

09:35 - 09:55 **Funds in Luxembourg Tax Law: an Overview**

Eric Fort (Arendt & Medernach)

10:00 - 10:20 **Funds and Value Added Tax**

Marie-Isabelle Richardin (PWC) & Charlène-Adline Herbain (University of Louvain/ University of Luxembourg)

10:25 - 10:45 **Recent Reforms in Germany**

Heribert Anzinger (Uni Ulm)

11:00 - 11:30 Coffee break

Funds Taxation and European Union Law

11:30 - 11:55 **Taxation of Collective Investments within the Legal Framework of State Aid**

Claire Micheau (EU Commission)

12:00 - 12:25 **Funds Taxation and Fundamental Freedoms**

Mario Tenore (Maisto e Associati)

12:30 - 12:55 **Funds and EU Tax Directives**

Katerina Pantazatou (University of Luxembourg)

13:15 - 14:15 Lunch break

Funds in International Tax Law and Policy – Part I

14:15 - 14:35 **The Interaction of Funds Regulation and BEPS**

Dirk Zetzsche (University of Luxembourg)

14:40 - 15:00 **Treaty Entitlement of Funds in a Pre-BEPS World**

Daniel Dürrschmidt (Ludwig-Maximilians-Universität München)

15:05 - 15:25 **Funds in International Tax Law:**

Examples from Luxembourg's Treaties

Jean Schaffner (Allen & Overy)

15:45 - 16:15 Coffee break

Funds in International Tax Law and Policy – Part II

16:15 - 16:40 **Treaty Entitlement of Funds in a Post-BEPS World**

Keith Lawson (ICI Global)

16:45 - 17:10 **Double Taxation Relief and Non-Discrimination of Funds**

Daniel Gutmann (University Paris 1 Sorbonne)

17:15 - 17:40 **Structuring of Funds: Practical Examples in Luxembourg**

Geoffrey Scardoni (DLA Piper)

18:00 **Closing of the Conference**

Werner Haslehner (University of Luxembourg)

A cocktail reception will follow the conference





The Future of Funds Taxation

Funds in Luxembourg Tax Law: an Overview

17 November 2016



Agenda

1. Introduction – definitions
2. The Luxembourg fund structuring toolbox
3. The Tax Neutrality Principle – Techniques
4. Tax Considerations
5. Tax Summary



1. Introduction – Definitions

- **“FCP”**: *fonds commun de placement*, fund of contractual form, equivalent to unit trust, no legal personality of its own.
- **“RAIF”**: reserved alternative investment fund governed by the law of 14 July 2016.
- **“SICAR”**: investment company in risk capital designed for private equity and venture capital investments, subject to the law dated 15 June 2004.
- **“SICAV”** : investment company, with variable share capital, as opposed to « **SICAF** » investment company with fixed capital.
- **“SIF”** : specialised investment fund subject to the law dated 13 February 2007.
- **“SOPARFI”**: *société de participation financière*.



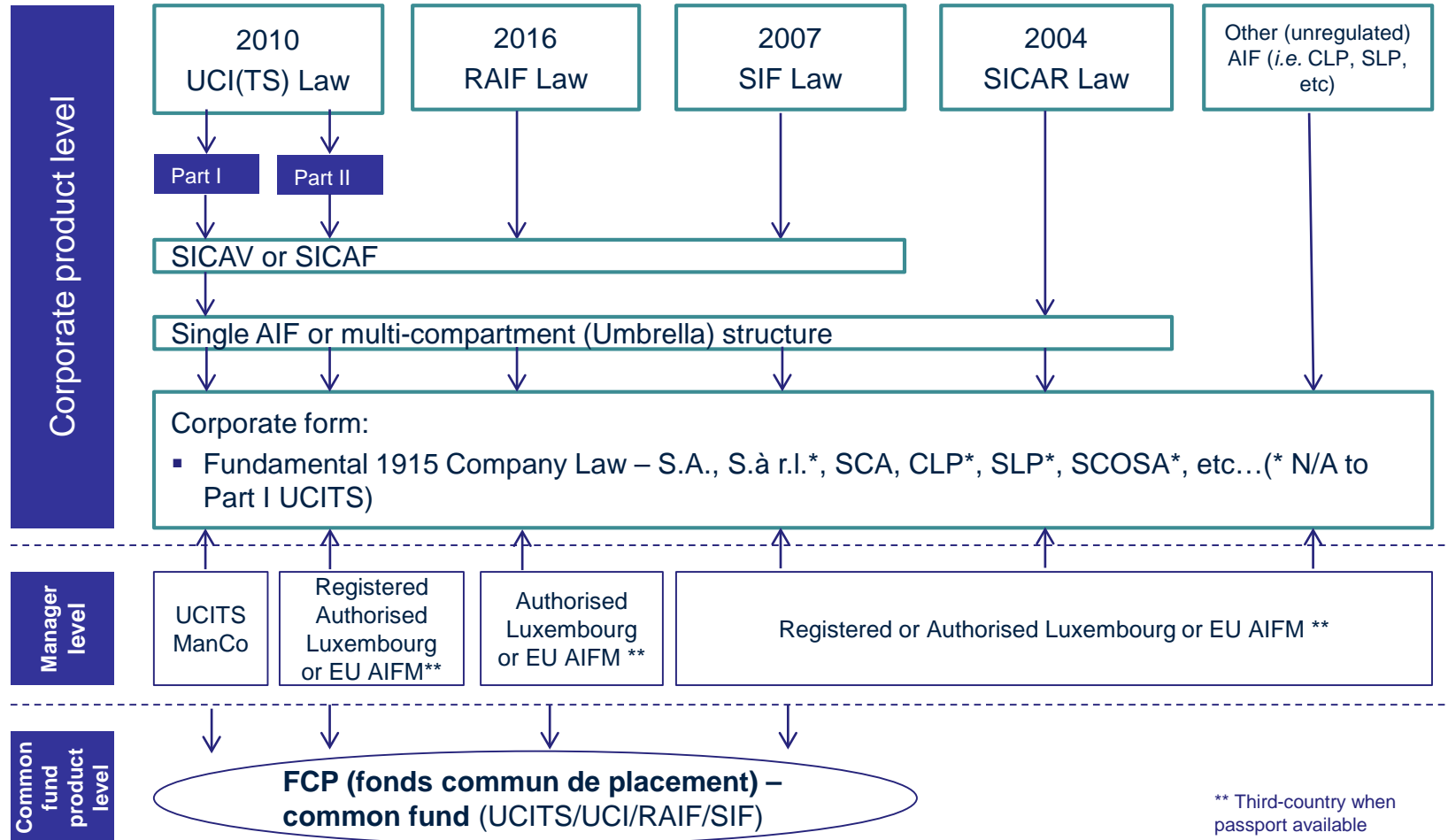
1. Introduction – Definitions

- **“Non-regulated”** means that the vehicle is not subject to the supervision of the Luxembourg regulatory authorities, unlike SICARs or SIFs,

does not mean that the vehicle is not governed by any Luxembourg law
i.e. SOPARFIs are governed by the Luxembourg law on commercial companies.

- **“UCITS”** : undertaking for collective investments in transferable securities – The Directive 2009/65/EC (the UCITS IV Directive) was implemented in Luxembourg by a law on 17 December 2010 which replaced the 2002 law.

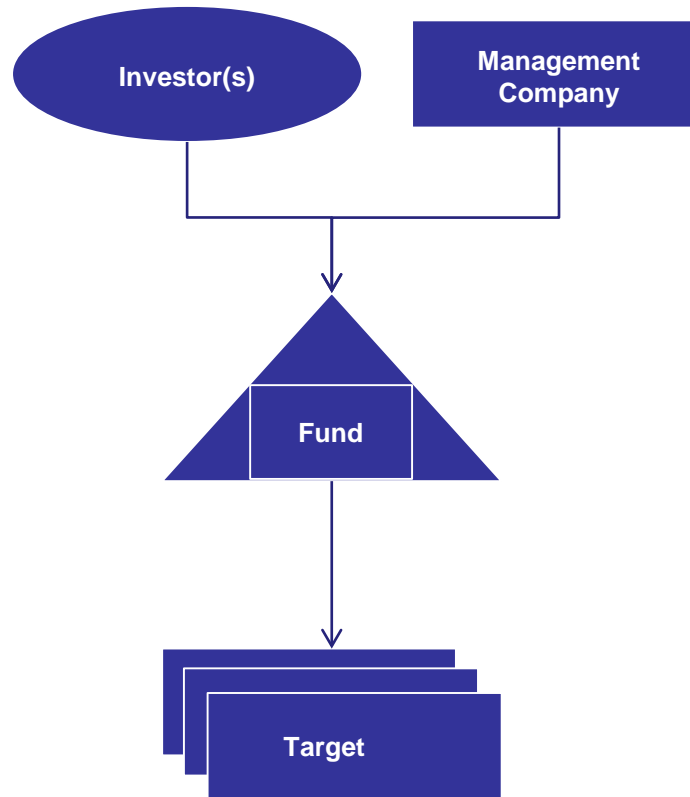
2. The Luxembourg Fund Structuring Toolbox





3. The Tax Neutrality Principle - Techniques

Luxembourg /
non-Luxembourg



Luxembourg

- Subjective Exemption
- Objective Exemption
- Tax Transparency
- Tax Base

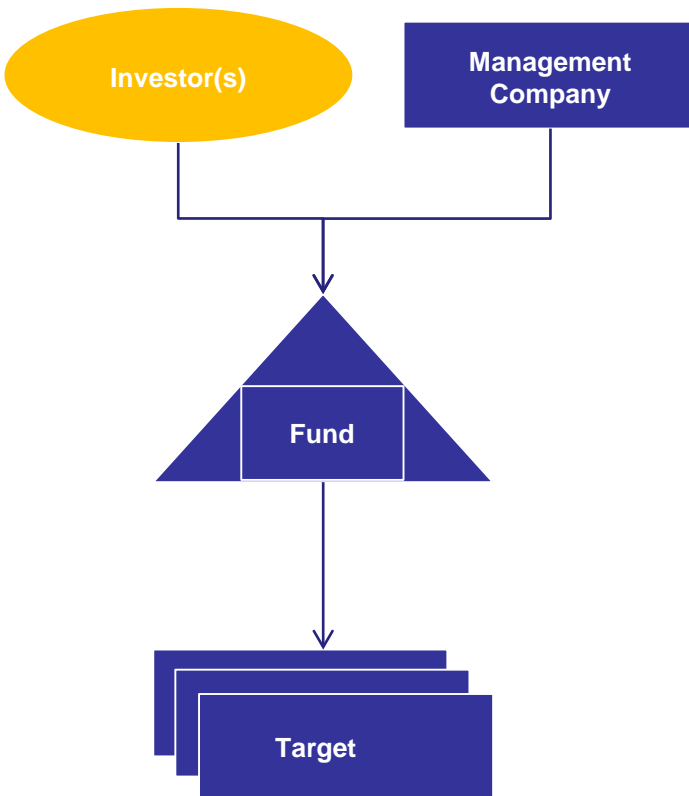
Luxembourg /
non-Luxembourg

4. Tax considerations

4.1. At the level of the Investor(s)

Tax treatment of the Investor(s) will depend on its/their tax residency

- **Non-Resident Investor(s) (not having a Luxembourg permanent establishment):**
 - Generally not liable to any Luxembourg taxes in relation to the interest(s) held on the Fund.
 - Exception (non applicable to SICAV/SICAF): subject to Luxembourg corporate tax if:
 - *(Indirect) holding - through the Fund (if applicable) - of a **substantial interest in a Luxembourg company** (i.e. more than 10% of the issued shares of that company, either alone or together with certain close relatives, at any time during the five-year period preceding the alienation); and*
 - *the **alienation** (including liquidation) **takes place within 6 months** after acquisition or (ii) in case of an alienation after 6 months or more, it has been a Luxembourg resident taxpayer for more than fifteen (15) years and have become a non-Luxembourg taxpayer less than five (5) years before the alienation takes place.*



4. Tax considerations

4.1. At the level of the Investor(s) (*continued*)

- Resident Investor(s) (or non-Resident Investor(s) having a Luxembourg permanent establishment):

- Taxable in Luxembourg on their worldwide income.

- For **corporate entities**: please refer to general tax treatment described under 4.3.

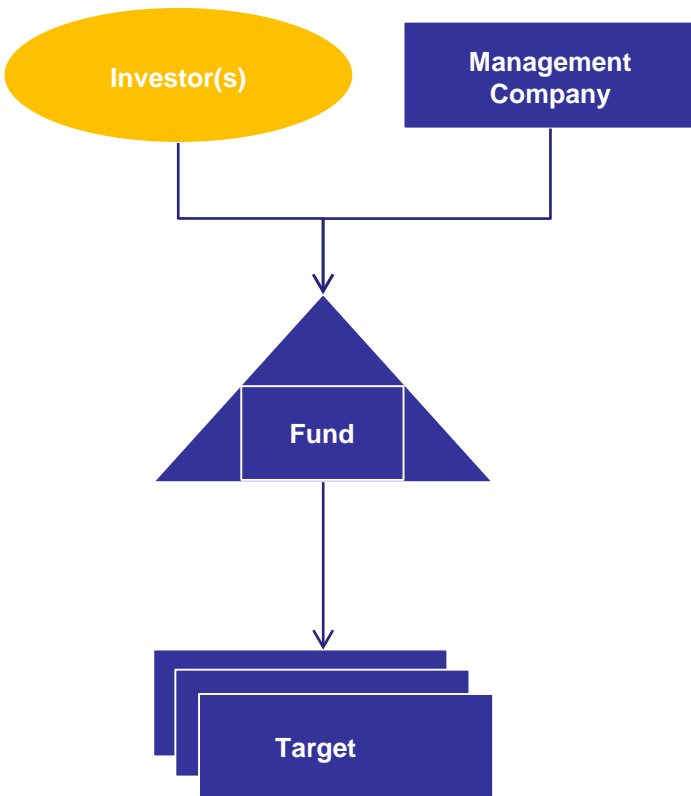
- For **natural persons**:

Luxembourg income rate (ranging from 0% to 43.60% in 2016 taking into account a surcharge corresponding to the employment fund contribution) plus budget balance tax of 0.5% (abolished in 2017);

No net wealth tax ("NWT") for individuals;

50% exemption on dividends received from fully taxable companies;

Capital gains on movable assets: no taxation after 6 month holding period (except in case of substantial participation - i.e. 10% - where a reduced tax rate apply).

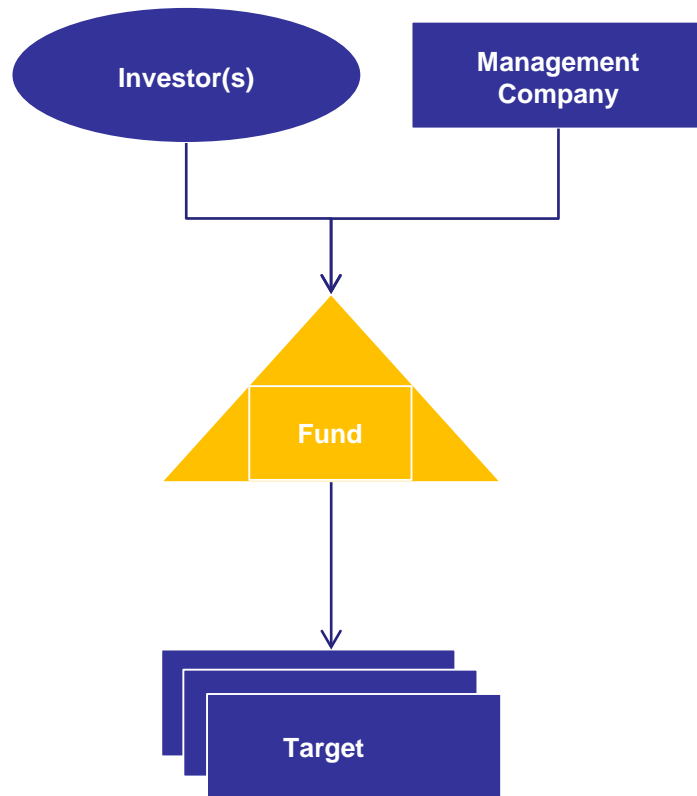


4. Tax considerations

4.2. At the level of the Fund

Tax treatment of the Fund will depend on its form:

- **SICAV – SICAF (UCITS/UCI/SIF)**
- **FCP (UCITS/UCI/SIF)**
- **Partnership (SIF)**
- **SICAR (under the corporate form of an opaque entity)**
- **SICAR (under the corporate form of a partnership)**
- **RAIF**



4. Tax considerations

4.2. At the level of the Fund (*continued*)

SICAV – SICAF (UCITS/UCI/SIF)

- **Set-up**

EUR 75 registration duty upon incorporation.

- **Ongoing**

Exemption for corporate income tax (“**CIT**”) municipal business tax (“**MBT**”) and NWT.

No withholding tax (“**WHT**”) on distributions made to investors.

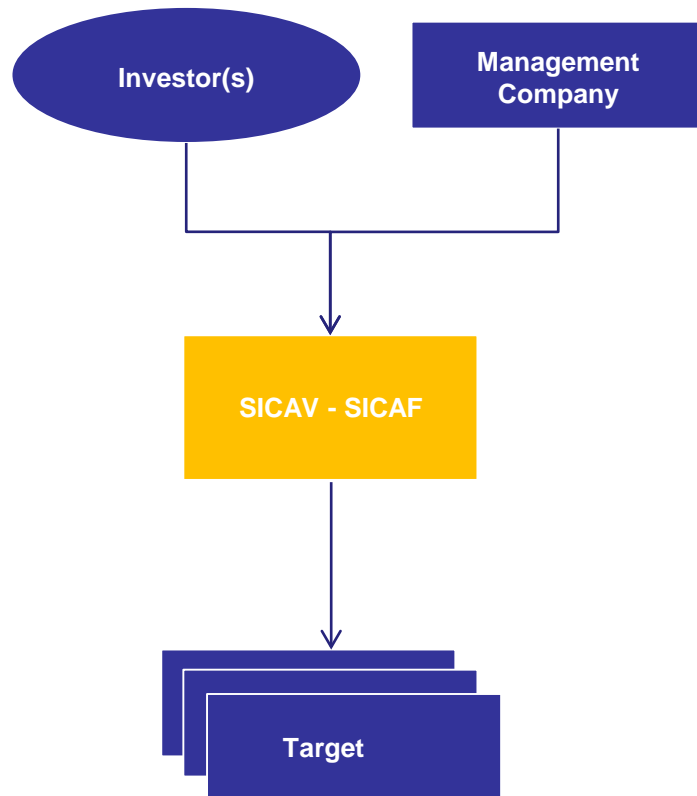
Subject to the *taxe d’abonnement* of 0.01% (SIF) or 0.05% on the net asset value for UCITS/UCI (exemptions for units or shares held in other Luxembourg UCI subject to the subscription tax, to certain funds - or individual compartments - investing in certain money market instruments or mainly in microfinance, to certain pension pooling funds and to exchange-traded funds).

- **Restructuring**

No adverse Luxembourg tax consequences in case of merger or demerger.

- **Liquidation**

No adverse Luxembourg tax consequences in case of liquidation.



4. Tax considerations

4.2. At the level of the Fund (*continued*)

FCP (UCITS/UCI/SIF)

- **Set-up**

No registration duty.

- **Ongoing**

Transparent entity for CIT/MBT and NWT purposes.

No WHT on dividends or capital gains.

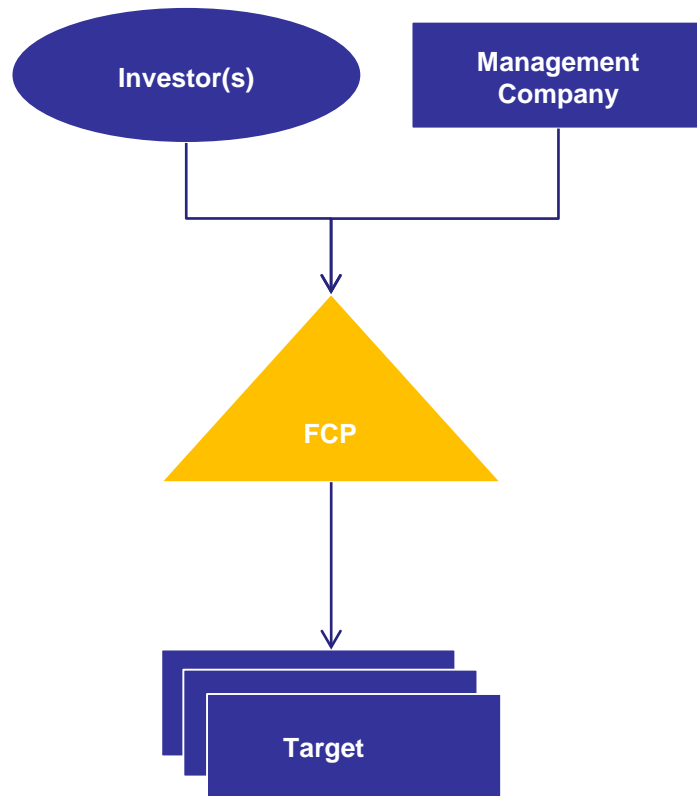
Subject to the *taxe d'abonnement* of 0.01% (SIF) or 0.05% on the net asset value for UCITS/UCI (exemptions for units or shares held in other Luxembourg UCI subject to the subscription tax, to certain funds - or individual compartments - investing in certain money market instruments or mainly in microfinance, to certain pension pooling funds and to exchange-traded funds).

- **Restructuring**

No adverse Luxembourg tax consequences in case of merger or demerger.

- **Liquidation**

No adverse Luxembourg tax consequences in case of liquidation.



4. Tax considerations

4.2. At the level of the Fund (*continued*)

Partnership (SIF)

- **Set-up**

No registration duty.

- **Ongoing**

Transparent entity for CIT/MBT and NWT purposes.

No WHT on distributions.

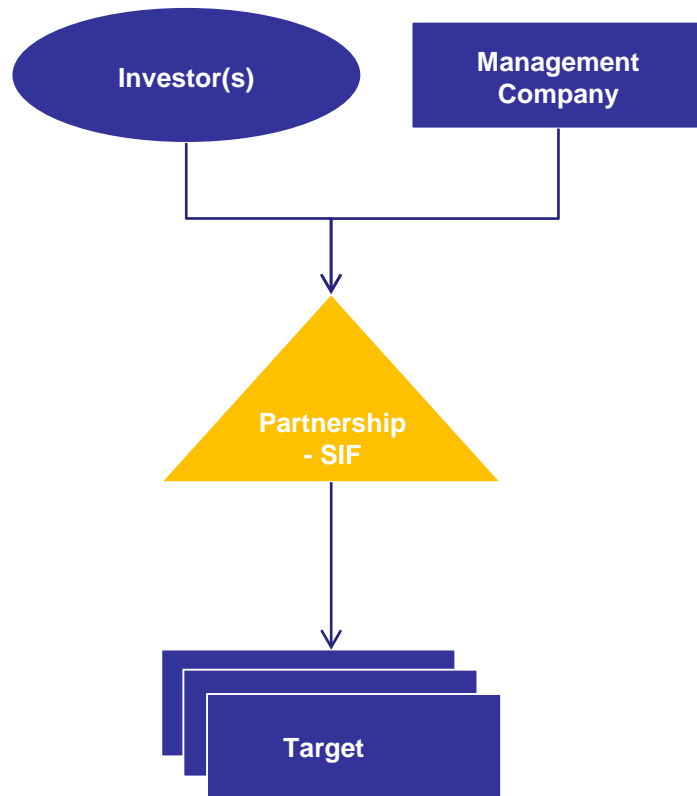
Subject to the *taxe d'abonnement* of 0.01% on the net asset value.

- **Restructuring**

No adverse Luxembourg tax consequences in case of merger or demerger.

- **Liquidation**

No adverse Luxembourg tax consequences in case of liquidation.



4. Tax considerations

4.2. At the level of the Fund (*continued*)

SICAR (under the corporate form of an opaque entity)

- **Set-up**

EUR 75 registration duty upon incorporation.

- **Ongoing**

Fully liable to CIT/MBT, however, exemption for income and capital gains realized on risk capital securities without further conditions.

No WHT on distributions made to investors.

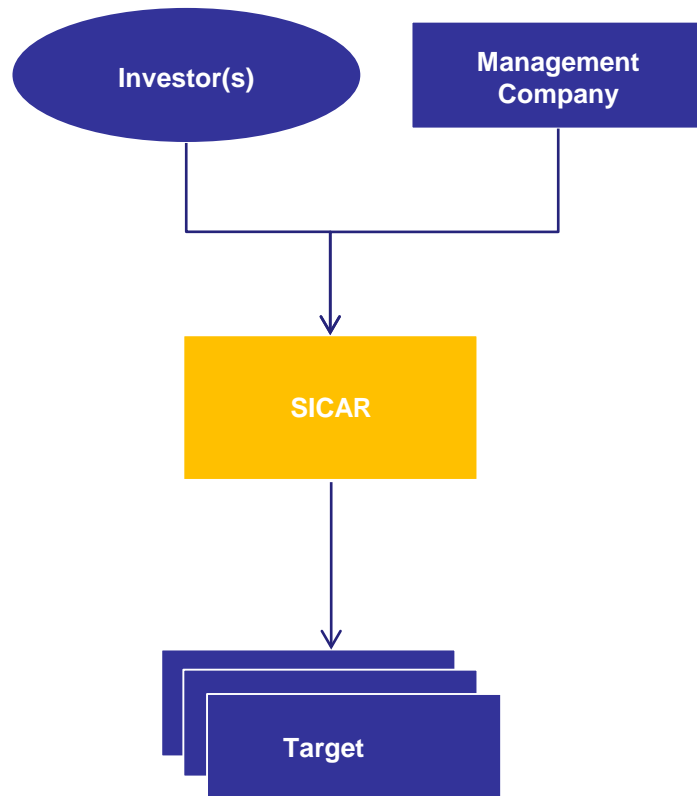
No NWT.

- **Restructuring**

No adverse Luxembourg tax consequences in case of merger or demerger.

- **Liquidation**

No adverse Luxembourg tax consequences in case of liquidation.



4. Tax considerations

4.2. At the level of the Fund (*continued*)

SICAR (under the corporate form of a partnership)

- **Set-up**

No registration duty.

- **Ongoing**

Transparent entity for CIT and NWT purposes.

No WHT on distributions.

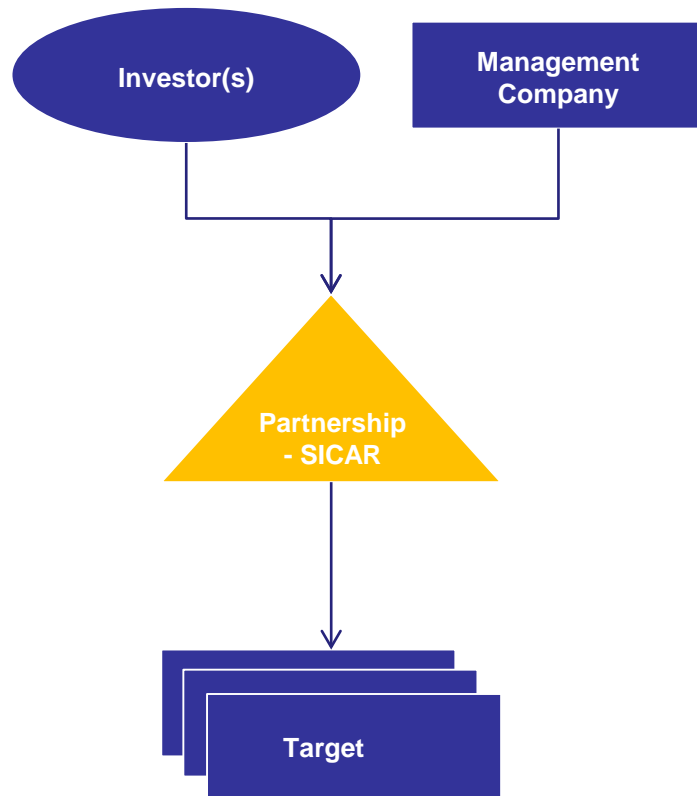
No subject to the *taxe d'abonnement* nor MBT (as far as, under the SICAR law, the SICAR is considered as not carrying out a business activity).

- **Restructuring**

No adverse Luxembourg tax consequences in case of merger or demerger.

- **Liquidation**

No adverse Luxembourg tax consequences in case of liquidation.



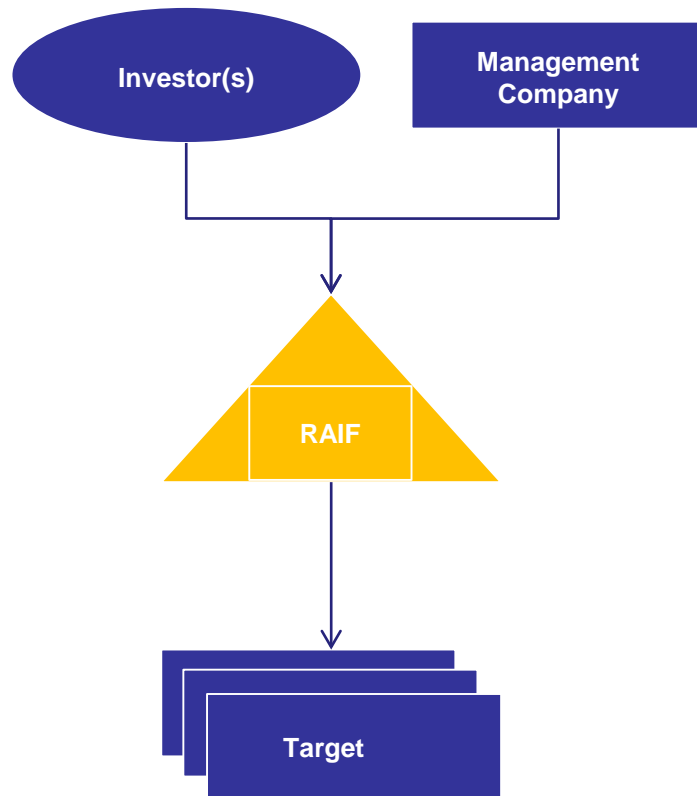
4. Tax considerations

4.2. At the level of the Fund (*continued*)

RAIF

➔ **Depends on selected tax regime:**

- If SICAR tax regime, please refer to SICAR section above.
- If SIF tax regime, please refer to SICAV/SICAF and FCP sections above.

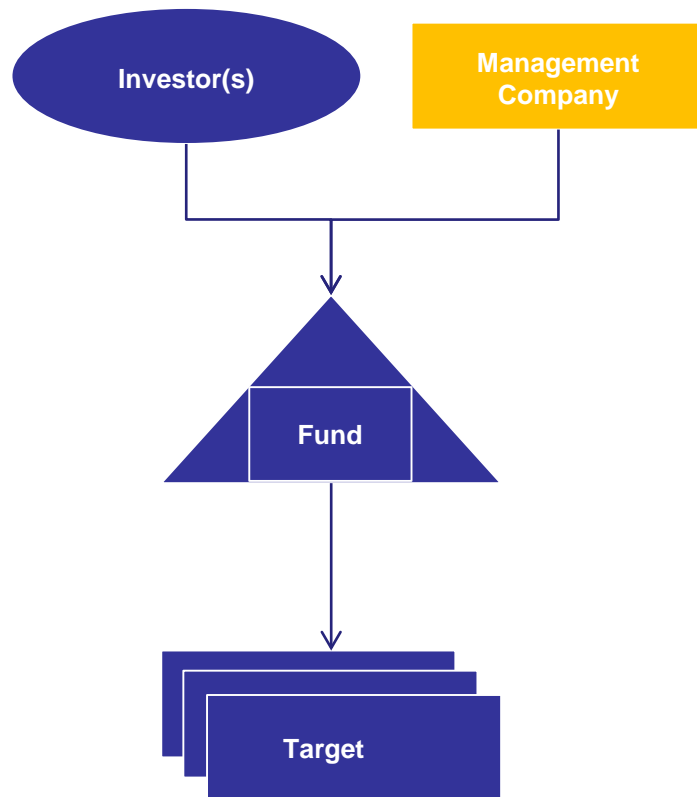


4. Tax considerations

4.3. At the level of the Management Company

Management Companies incorporated under Luxembourg Law are subject to the ordinary tax regime applicable to corporate entities in Luxembourg

- Taxes on Income: 29.22% in 2016 in Luxembourg-city
 - CIT: 22% (18% in 2018 according to the 2017 Luxembourg tax reform);
 - MBT: 6.75% (Luxembourg-city);
 - Employment Surcharge.
- WHT:
 - On dividends: 15%.
 - On interest: 0% (in general) except:
 - 10% (Luxembourg resident individuals);
 - Certain limited cases (e.g. silent partnership / profit-participating bonds).
 - On royalties: 0%.
 - On distribution of liquidation proceeds: 0%.
- NWT: 0.5% (or 0.05%) on 1 January computed on net asset value – Minimum NWT EUR 3,210 (EUR 4,815 in 2017 according to the 2017 Luxembourg tax reform) or progressive tax scale.
- Value Added Tax (“VAT”): a VAT exemption applies in Luxembourg for services qualifying as fund management services.



4. Tax considerations

4.4. Focus on exchange of information

- **WHT on dividend/liquidation proceeds:** no WHT as a rule – however UCITS are in the scope of the exchange of information (the Savings directive has been abolished and replaced by the automatic exchange of information - 2014/107 directive or “DAC 2” implementing the Common Reporting Standard (CRS)*).
- Based on the automatic exchange of information (much broader than the Savings), the information on **any interest, dividend and other income generated** to be provided in respect of each account will be: name; address; date and place of birth; tax identification number (where applicable); account number; name and identifying number of account provider and account balance or value as at end of the calendar year or other appropriate period.



* Luxembourg law of 18 December 2015 on the implementation of the Common Reporting Standard (CRS law)



5. Tax Summary

| Comparative analysis | | | | |
|---|--|---|--|--|
| | SOPARFI | SICAR and RAIF SICAR like taxation | Regulated Funds (SICAV, SICAF, FCPs) | SIF and RAIF not SICAR like taxation |
| 1. Direct tax | Fully subject to tax (29.22%) | Fully subject to tax (29.22%) but exemption available | Tax exemption (+ transparency for FCP) | Tax exemption (+ transparency for FCP) |
| 2. Withholding tax | 15% on dividends (except participation exemption or treaty reduction) Nil on interest and liquidation proceeds | No | No | No |
| 3. Net Wealth Tax and Minimum Net Wealth Tax | Yes (NWT & MNWT) | Yes (NWT & MNWT) | No | No |



5. Tax Summary

| Comparative analysis | | | | |
|----------------------|--|--|---|---|
| | SOPARFI | SICAR and RAIF SICAR like taxation | Regulated Funds (SICAV, SICAF, FCPs) | SIF and RAIF not SICAR like taxation |
| 4. Indirect Taxes | EUR 75 capital duty No VAT exemption on management services | EUR 75 Registration duty VAT exemption on management services | EUR 75 registration duty 0,05% subscription tax but exemption and reduced rate VAT exemption on management services | EUR 75 registration duty 0,01% subscription tax but exemptions VAT exemption on management services |



Questions ?



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Agenda

Introduction

A real fund life case

Is a fund a VAT taxable person?

Scope of the fund management VAT exemption under the Luxembourg VAT legislation

Input VAT recovery?

VAT on funds directors' fees?

*A real fund life case**



VAT taxable status?

Place of supply (transactions 1 and 2)?

VAT exemption?

Who is liable?

Input VAT recovery?

* Decision of the Luxembourg Court of Appeal dated 10 August 2016 (case n° 148/16 – II – CIV, register 39533)

Is a fund a VAT taxable person?

- CJEU, BBL case, 2004: SICAV = VAT taxable person
- Luxembourg : Circular 723, 2006: Entity benefiting from the fund management VAT exemption = VAT taxable person

AIF:

Self-determination

Absence of legal personality

FCP + management company
≠
SCSp + GP(s)

**Art. 9, 1
VAT
Directive**

Pension funds DB schemes:

Wheels C-424/11
≠
Lux VAT Law

Pension funds
&
Wheels Case

**RAIF
v
X Case**

Consequences of the VAT status:

- Registrations
- Compliance
- Place of supply

Scope of the fund management VAT exemption (Article 44,1,d of the Luxembourg VAT Law)

Services covered by the VAT exemption

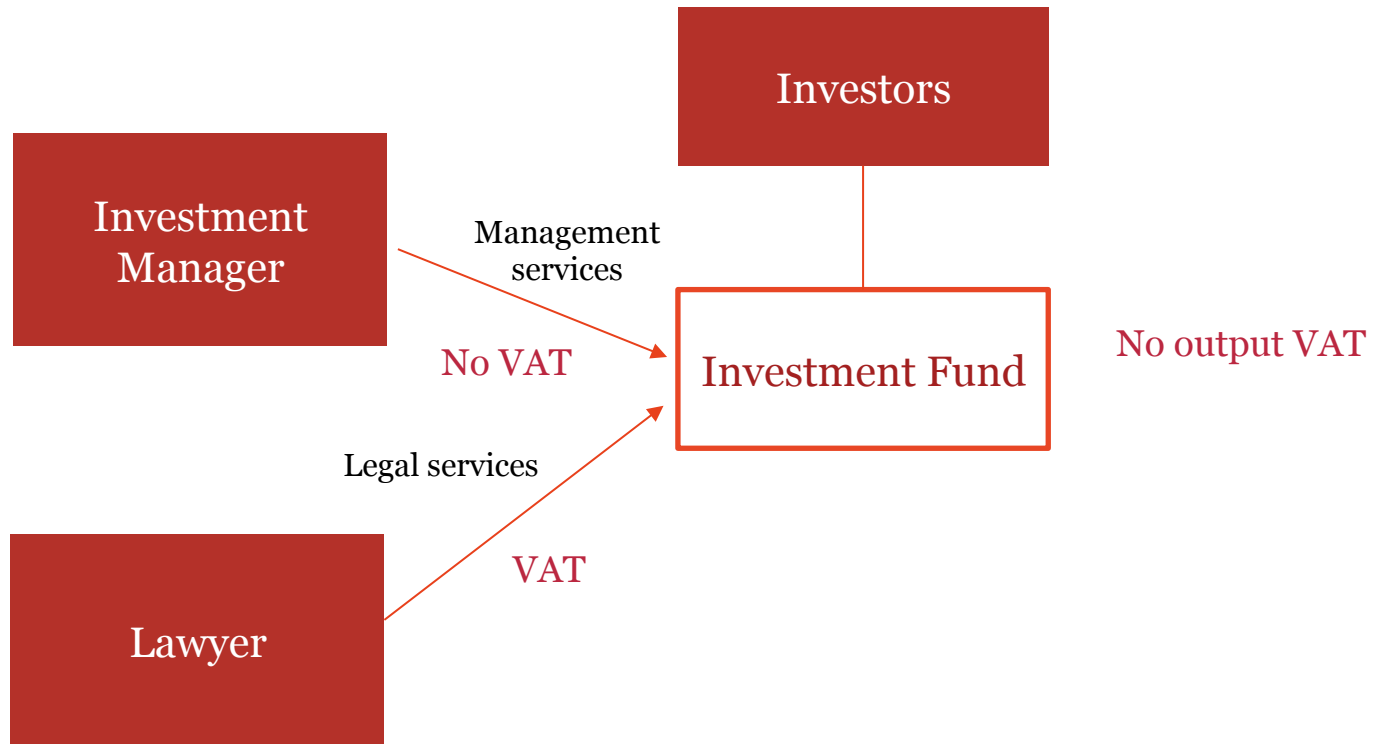
- Services that are specific to and essential for the management of the funds. This includes portfolio management but also tasks of administering the funds such as those set out in Annex II to the UCITS Directive.
- In case where fund administration services are **outsourced** to third party managers, for being VAT exempt, the services need to:
 - form a distinct whole and
 - be specific to, and essential for, the management of the fund (Circular 723).
- The outsourcing of only one “isolated” type of services cannot benefit from the VAT exemption (Circular 723bis).
- Risk management functions are also VAT exempt (Circular 723ter).

Scope of the fund management VAT exemption (Article 44,1,d of the Luxembourg VAT Law)

Vehicles covered by the VAT exemption (since 12 July 2013)

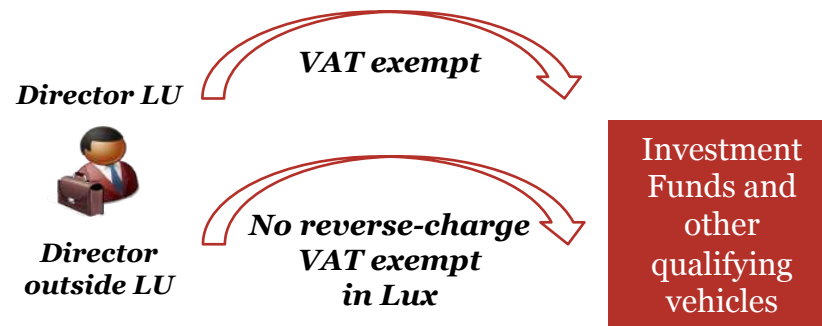
- Entities subject to the supervision of the CSSF or CAA,
 - Investment funds (i.e. SICAV, FCP, SICAF)
 - Specialised investment funds
 - SICARs
 - Pension funds
- Similar EU vehicles as listed above subject to the supervision of a supervisory body equivalent to the CSSF or CAA,
- Securitisation vehicles covered by the Law of 22 March 2004 on securitisation and similar vehicles which purpose is to carry out securitisation transactions (...),
- Alternative Investment Funds (including RAIF).

Input VAT recovery?

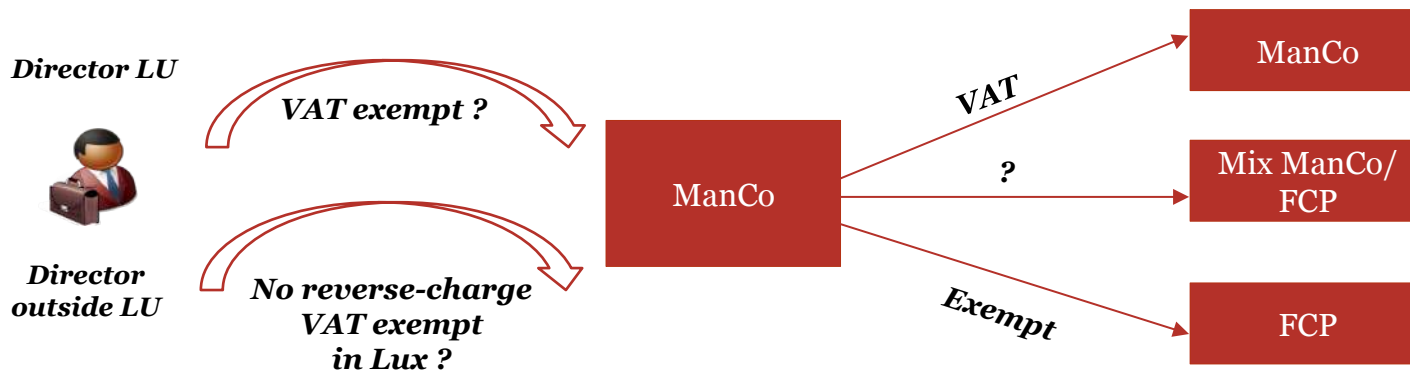


Circular 781 on VAT and directors' fees

Remuneration received by directors of qualifying investment funds



The Circular does not clearly indicate whether the application of the fund management VAT exemption (article 44.1.d) of the Luxembourg VAT law) can apply to directors on the board of qualifying investment funds and/or in management companies managing these funds. The VAT exemption should however not be challenged to the extent the functions of the directors are specific and essential for the management of these funds.



Questions?

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Recent Reforms in Germany

Prof. Dr. Heribert M. Anzinger
Universität Ulm

The Future of Funds Taxation
Université du Luxembourg
18. November 2016

History of German Funds Taxation



Liebe Verschuler, Die kurbrandenburgische Marine auf hoher See, 1684, Gemeinfrei



Brandenburgisch-Afrikanische Compagnie

Zicker'scher Kapitalverein

Sitz: Königs Wusterhausen bei Berlin. Postfachkonto: Berlin 131 223.
Vereinigung zur gemeinsamen Anlage und Verwaltung von Vermögen und Kapital.

| | | |
|--|---|---|
| <p>Wert eines Anteils am 30. 6. 1924 5,80 G.-M.</p> <p>Bis zum 5. eines jeden Monats können neue Anteile zum Werte vom Ende des Vormonats erworben werden.</p> | <p>Dauernde Gelegenheit zu Einzahlungen von barem Gelde. Für Zahlungen nach dem 5. eines Monats werden bis zum Ende des Monats 24% Zinsen p. a. vergütet.</p> | <p>Rückzahlung von Anteilen am Schluß eines jeden Monats nach Kündigung. Den Mitgliedern werden außerdem Vorschüsse auf die Anteile gegen 24% Zinsen p. a. gewährt.</p> |
|--|---|---|

Mitgliederzahl am 30. 6.: 1768
Zahl der Anteile am 30. 6.: 30 483
Gesamtvermögen am 30. 6.: 176 627,09 G.-M.

Current Fund Taxation Rules (1957 – 2017)

InvStG idF. AIFM-Steuer-Anpassungsgesetz v. 24.12.2013

- **KAGG (1957), InvG/InvStG (2003), KAGB/InvstG (2013):**
 - Semitransparency of Mutual Retail Funds and Special Investment Funds
 - Funds as „Tax Exempted Tax Subjects“
 - Funds Privileges and Requalification of Income
- **InvStG (2013)**
 - No major Changes
 - “Investmentvermögen” and “Investitionsgesellschaften”

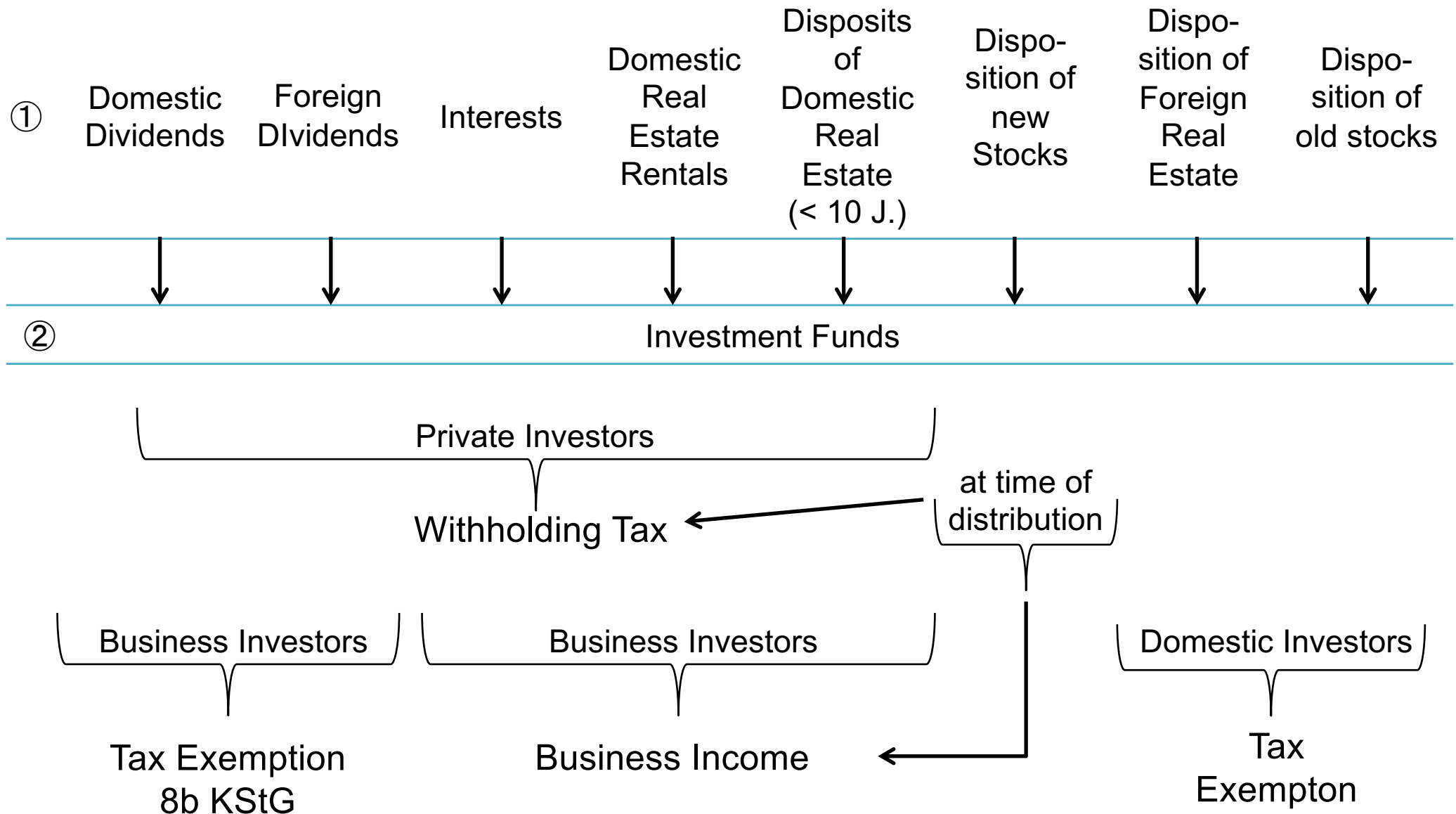
Current Fund Taxation Rules (1957 – 2017)

InvStG aab. AIFM-Steuer-Anpassungsgesetz of 24.12.2013

- **Domestic Funds**
 - Corporate Tax Subject – but Full Tax Exemption
 - Source-WHT-Exemption on Dividends and Interests ...
 - ... linked to Fund Level WHT on Dividends, Interests and Real Estate Income – Tax Deferral on Investment Capital Gains – Tax Exemption on Long Term Real Estate Capital Gains
- **Foreign Funds**
 - **No** Source-WHT-Exemption on Domestic Dividends ...
 - ... linked to **no** Fund Level WHT of Foreign Funds
 - Therefore: Dividends income effectively taxed according to Treaty Law at 15 %

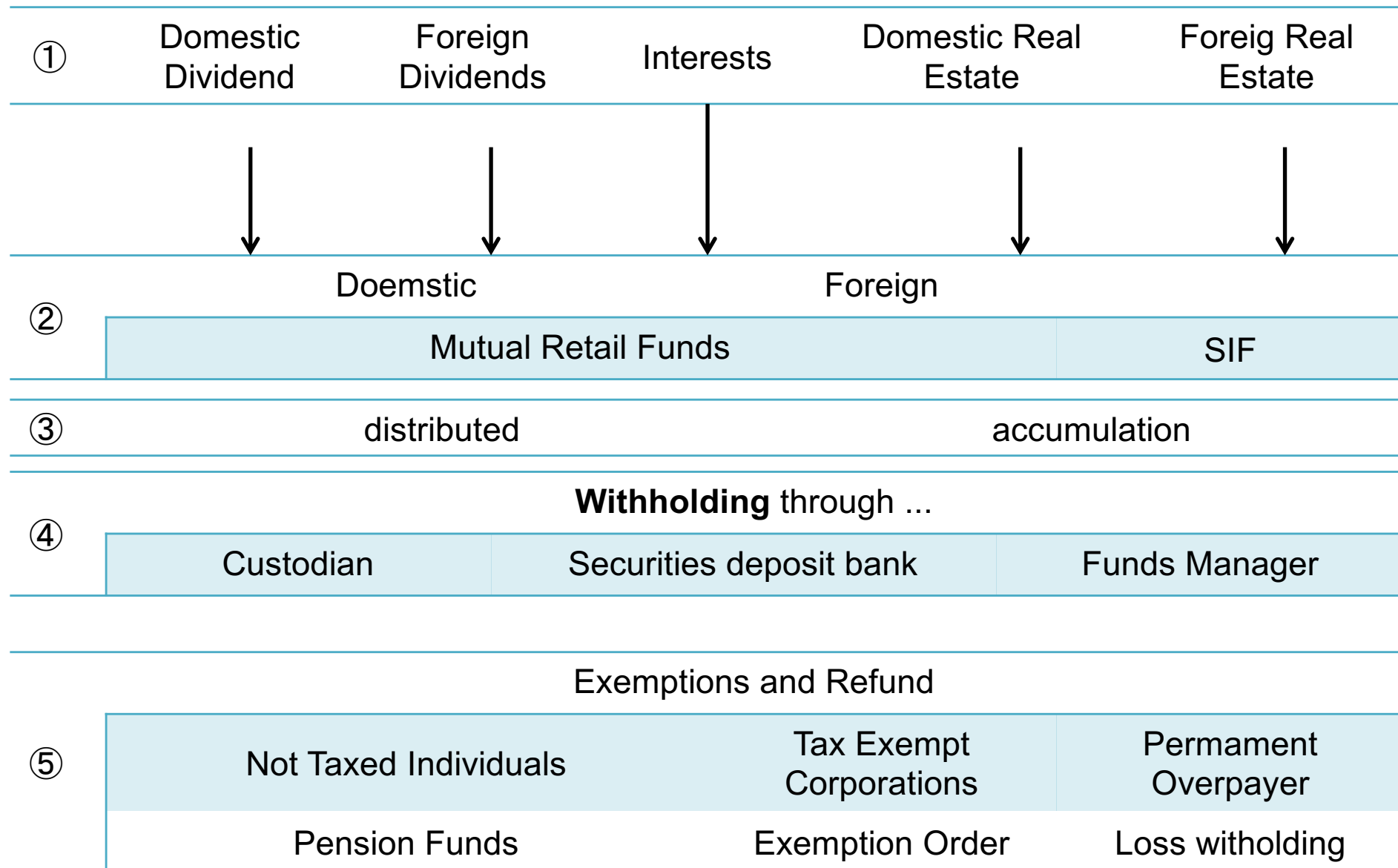
Current Fund Taxation Rules (1957 – 2017)

Link between Funds Level – Investor Level – Domestic Investors



Current Fund Taxation Rules - Withholding Tax Regime

Funds Distributions and Deemed Distributions (§ 7 InvStG)



Needs for a Reform

Complexity, Fragility, Legal Uncertainty

- **Complexity**
 - 33 items to be publicly reported
 - 12 loss schedules
 - Error Correction Procedures
- **Fragility**
 - Cum-/Ex- und Cum-/Cum-Trades
 - Bondstripping
 - Bull-Bear-Transacations
- **Legal Uncertainty and conflicts with EU Law**
 - EU Law Freedoms and their Restrictions
 - WHT-Exempt only for domestic funds justified by coherence?
 - ECJ 20.5.2008, C-194/06 – Orange Smallcup Fund
 - ECJ 18.6.2009, C-303/07 – Aberdeen Property Fininvest Alpha
 - ECJ 10.5.2012, C-338-347/11 – FIM Santander
 - ECJ 10.4.2014, C-190/12 – Emerging Market
 - ECJ 9.10.2014, C-326/12 "van Caster und van Caster"

Different Ideas – EU Law driven - Discussion

Modified Transparency vs. New Opaque

Modified Transparency

- **Full Transparency**
 - Taxation like Non Business Partnerships = Transparency
 - P: Number of different income types -> complex reporting requirements
 - Purpose of Investment Law: Reducing Complexity – Neutrality
- **Modified Transparency** - Stronger Link between Fund Taxation and Investor Taxation

New Opaque

- **Reducing Complexity**
 - By separation of funds level and investor level
 - Taxation like Corporation – but ...

Growing of New Opaque Idea

- 15.12.2011 / 24.2.2012 – Bund-/Länder-Report on Investment Tax Reform
 - Proposal in favor of New Opaque
 - Impact Study Copenhagen Economics of 17.11.2014
 - No significant impact on tax burden and level playing field
- Discussion Draft of 21.7.2015
- Draft of Federal Ministry of Finance of 16.12.2015
- Draft of Federal Government of 16.2.2016
- Official Gazette of 26. Jul. 2016
- Application from 1. Jan. 2018

The New German Funds Taxation (2018 ff.) Radical Reform?



The former castle brewery in Kolín, Wikimedia - CC BY-SA 3.0

The New German Funds Taxation (2018 ff.)

Scope: „Investmentfonds“

- **Linked to regulatory law**
 - Domestic as Foreign Funds
 - Collective Investment Schemes within the meaning of the German Capital Investment Act (Kapitalanlagegesetzbuch)
 - Including parent undertakings and subsidiaries of an AIFM within that meaning
 - Including Corporate Investment Companies
- **And**
 - All one Investor Investment Vehicles
- **Not**
 - Partnerships, if not UCITS or Pension Scheme
 - therefore closed-ended funds organized as partnerships are not in the scope of the new Investment Tax Regime (Lux. SCS/SCSp, Delaware LP)
 - Companies according to the German Participation Companies Act – Public Participation Companies
 - REITS

The New German Funds Taxation (2018 ff.)

Domestic – Foreign Funds Criteria

- **Basic Principle**
 - Equal Treatment of Domestic and Foreign Funds
 - No additional investment requirements for Mutual Retail Funds
 - Domestic Funds: „Zweckvermögen“ (Corporate Tax Subject)
 - Foreign Funds: „Vermögensmassen“ (Corporate Tax Subject)
- **Qualification of Domestic – Foreign Funds**
 - Regulatory Approach
 - Applicable Civil Law
 - Not relevant (as discussed prior)
 - ~~Statutory Seat~~
 - ~~Principle Place of Management~~
 - ~~Permanent Establishment~~

The New German Funds Taxation (2018 ff.)

Two Systems in one Book

- **Basic Rules (Separation Principle)**
 - New Opaque Tax Regime: Intended for Mutual Retail Funds but applicable also on Special Investment funds
 - Investment Funds subject to corporate tax – Limited Tax Liability – New Funds Privileges – Base Yield Lump Sum Taxation
 - Potential double Taxation on Funds and Investor Level needs compensation through partial exemptions
- **Optional tax regime for specialized investment funds**
 - Based on previous Investment Tax Regime
 - Modified transparency

Mutual (Retail) Funds (2018 ff.)

Investment Fund Level – Quasi Corporate Tax

- **Basic Principle (Scope: All Investment Funds)**
 - Domestic and Foreign Funds as Corporate and Trade Tax Subject
 - Corporate Tax (15 % or 15,825 %) – but only on ...
 - ... see next slide
 - Final Withholding Tax on incoming Dividends – If only Dividend Income: No Tax Declaration Requirements at Fund Level
 - (Still) Exemption of German Trade Tax as long as no *material* trade (New: negligible trade does not hurt – 5 % Threshold)
- **Exception**
 - Charitable Investors / Churches / Foundations (see next slide)
- **New Opaque = New Design** of former deemed distributed income WHT-Taxation (KESt goes KSt)
 - 15 % on domestic dividends not much difference on previous treatment of foreign funds

Mutual (Retail) Funds (2018 ff.)

Investment Fund Level – Investor Related Tax Exceptions

- **Full Tax Exemption**
 - Charitable Investors, Churches, Foundations with statutory seat or principle place of management in states which are according to the mutual administrative assistance directive
 - Certified Pension Schemes (Riester/Rürup)
- **Tax Exemption of Real Estate Income**
 - Domestic Public Entities
- **Preconditions**
 - Separation of Funds with favoured investors
 - or mixed investor funds and pro rata tax exemption

Mutual (Retail) Funds (2018 ff.)

Investment Fund Level – Quasi Corporate Tax – Tax Base

- **Domestic participation income (15 %)**
 - Dividends from corporate entities in Germany, manufactured dividends, securities lending fees
 - No exemption on dividends under § 8b KStG, even if 10 % threshold is exceeded,
 - ... but *exemption of capital gains* on shares
- **Income from domestic real estate (15,825 %)**
 - Rental income
 - Capital gains – irrespective of holding period – Transition rules for dispositions of real estate more than 10 years after acquisition
- **Other domestic income (15 - 15,825 %)**
 - ...within the scope of limited taxation defined by the patchy catalogue of § 49 Abs. 1 EStG, *except profits from the disposition of significant investments*
 - e.g. interests from mortgage backed loans

Mutual (Retail) Funds (2018 ff.)

Investment Funds Level – Quasi Corporate Tax – Not Tax Base

- **Further Funds Privileges**
- **No Tax Income at Funds Level**
 - Interests
 - Gains of domestic and foreign Investment (proceeds in the disposition of stocks)
 - Foreign Dividends
 - Income from Foreign Real Estate

Mutual (Retail) Funds (2018 ff.)

Funds Level – Treaty Entitlement

- **Design of Transparency in the Current Tax Regime**
 - Corporate Tax Subject - Unlimited Tax Liability of Domestic Funds
 - Tax Exemption
- **Design of New Opaque**
 - Corporate Tax Subject
 - Limited or Unlimited Tax Liability?
 - Opinion 1: Limited Tax Liability on Domestic Income – Arg. § 6 Par. 2 S. 1 InvStG n.F.: „Investmentfonds unterliegen mit ihren inländischen Beteiligungseinnahmen ...“.
 - Opinion 2: Unlimited Tax Liability and Tax Exemption of foreign income
- **Art. 4 Par. 1 S. 2 OECD-MT:**
 - „This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.“

Mutual (Retail) Funds (2018 ff.)

Investor Level – Principles – Tax Base

- **Cash Flow Taxation**
- **Distributions**
 - Accruing to Investors
 - Including repayments of capital (Exception: Liquidation of Funds)
- **Vorabpauschale**
 - Base Yield Lump Sum / Pre-Determined Tax Base
 - Substitute of former deemed distributed income
- **Capital Gains**
 - Disposition and Redemption of interests in investment funds

Mutual (Retail) Funds (2018 ff.)

Investor Level – Principles – Income Qualification and Tax Rate

- **Domestic Investors**
 - Private Investors: Capital Income, Withholding Tax-Rate
 - Business Investors:
 - No Partial Income taxation but Special Partial Exemptions to avoid Double Taxation on Funds and Investors Level
 - Corporate Investors:
 - No Corporate Tax exemption but Special Partial Exemptions to avoid Double Taxation on Funds and Investors Level
- **Foreign Investors**
 - No limited tax liability – not domestic income according § 49 EStG
 - No Withholding Tax – substituted through Corporate Tax

Mutual (Retail) Funds (2018 ff.)

Investor Level – Base Yield Lump Sum (Pre-Determined Tax Base, „Vorabpauschale“)

- **Deemed Minimum Yield**
 - Base Interest Rate defined in § 203 para. 1 German Valuation Act (BewG) – Average Return on Long Term Government Bonds
 - Published yearly by Federal Ministry of Finance – 2016: **1,1 %**
 - Diminished by 0,3 % as deemed income-related-expenses = 70 % of Base Interest Rate
- **Base of Redemption Price** of the Investment Fund at the beginning of the year
- **Capped** by gain of value of interests in investment funds during the year
- **Diminished by distributions**
- **Reduced** by Partial Exemptions (see following slide)
- Deemed to be received in the immediately **following calendar year**

Mutual (Retail) Funds (2018 ff.)

Investor Level – Partial Income Method (Partial Exemptions)

- **Typing Prior Tax Impositions on Earnings**
- **Equity Funds**
 - Continuously min. 51 % of the assets in capital interests
 - Partial Exemption: 30 % (60 % if interests are business assets of natural persons, 80 % if interests are assets of a corporate taxed person – not for trading by Financial Services Provider, not for WHT)
- **Real Estate Funds**
 - continuously invested min. 51 % of the assets in real estate
 - Partial Exemption: Domestic real estate: 60 %, Foreign real estate: 80 %.
- **Mixed Funds**
 - Continuously invested min. 25 % of the assets in capital interests
 - Half of the Partial Exemption of Equity Funds
- **Funds of Funds**
 - Interest in Real Estate Funds = 51 % Real Estate
 - Interest in Equity Funds = 51 % capital interests

Mutual (Retail) Funds (2018 ff.)

Investor Level – Partial Income Method (EU Law Conformity)

- **Partial Income Exemption** only in favour of Domestic Investors
- **Discrimination?**
 - Opinion 1: Investment Income of foreign investors is not taxable at all – no burden no discrimination
 - Opinion 2: Taxation at Funds Level is partly neutralised by partial income method – burdens only foreign investors - discrimination

Special Investment Funds

Scope I

- **Closed list of legal forms** for domestic funds
 - Sondervermögen and InvAG with variable capital – not InvAG with fixed capital – not closed InvKG
- **Max. 100 Investors**
 - Look through Partnerships
- **Restrictions for Natural Persons**
 - Only Business Individuals, Participation of natural Persons required for regulatory reasons, indirect participations held before 9. Jun. 2016
- **Funds or Funds Manager Subject to investment regulation**
 - Therefore also unregulated Funds which are managed by a manager authorized under AIFMD – Société de gestion patrimoine familial

Special Investment Funds

Scope II (Cont.)

- **No material Trade**
 - Funds need to be exempted from German Trade Tax
 - Trade Income max. 5 % of total income
- **Taxation related product regulation (§ 26 InvStG)**
 - Catalogue introduced by implementation of AIFM-Directive
 - At least 90 % of the funds net asset value needs to be invested in defined assets
 - UCITS Requirements / Eligible Assets Directive
 - Also participations in closed-ended funds

Special Investment Funds (SIF)

Check the Box – Opaque or Transparent – Equity Funds

- **Transparency Option**
 - Irrevocable Declaration against WHT-obliged parties not to issue capital gains tax certificates in favour of funds but in favour of investors
 - WHT on income at the fund level deemed to be withdrawn on the account of the investors not on the account of the funds
- **Without Transparency Option**
 - Opaque Taxation like Mutual (Retail) Funds

Special Investment Funds (SIF)

Check the Box – Opaque or Transparent – Real Estate Funds

- **Transparency Option**
 - Withholding tax on distributions and deemed distributions of domestic real estate income
 - Withdrawn by SIF
 - Capital gains tax certificates in favour of investors
 - Tax Exemption from Corporate Taxation
- **Without Transparency Option**
 - Opaque Taxation like Mutual (Retail) Funds

Special Investment Funds (SIF)

Transparency Option - Investors Level – Tax Base

- **Income**
 - Distributed income
 - Deemed distributed income
 - No exemption of gains in real estate with holdings periods > 10 years (so in previous law)
 - Still exemption of capital in stocks and further investment with new limitation to 15 years tax free accumulation (Reduction of the Funds Privilege)
 - Capital Gains from Disposition and Redemption of interests in investment funds
- **Object of Corporate and Trade Income Tax**
 - No withholding tax rate, no partial exemptions
 - Disadvantage against previous law and against direct investment

Special Investment Funds (SIF)

Funds Privilege and Tax Exemption for Investment Income

- **Still tax free accumulation of**
 - proceeds from option premiums
 - capital gains from dispositions and forward transactions (shares, debt instruments, investment participations)
 - ... but limited on a time period of 15 years with loss carry forward
- **Tax Exemption for Investment Income of Corporate Investors**
 - Dividends from Real Estate Companies, PPP project companies, companies producing renewable energy
 - ... if investor holds directly or indirectly at least 10 % of the shares
 - Capital Gains from shares
 - Not for Credit Institutions, financial service providers, financial enterprises

Special Investment Funds (SIF)

Check the Box – Opaque Tax Regime

- **Funds Level**
 - Corporate Tax: 15 – 15,825 % on domestic income
- **Investor Level – Partial Income Method (Partial Exemptions)**
 - **Domestic Investment Income:**
 - Basic Rule: 60 % Partial Exemption
 - If Investor Subject to German Corporate Tax and WHT not Capped to at least 15 % by Treaty Law: 100 %
 - **Domestic Real Estate Income:**
 - Basic Rule: 20 % Partial Exemption

Special Investment Funds

No need for a Reform?

- **SIF less Complex?**
 - Limited number of investors less complex and easier to audit
 - Limited number of funds and investors allows concentration of expertise in few tax agencies
- **... less vulnerable through aggressive tax planning?**
 - Cum-/Ex- and Cum-/Cum-Schemes were not enabled by loopholes in the investment tax regime
 - Some Corrections
 - SIF easier to monitor
- **EU Law Conformity?**
 - Transparency Option clarifies Pass Through Idea

Transitional Provisions

- New Law **applicable beginning on 1. Jan. 2018**
- **Investor Level**
 - Deemed disposition of all interests on 1. Jan 2018 – determination of gains and losses – but no taxation at that moment.
 - Deferred taxation – until disposition or redemption of the interests in the funds
 - Grandfathering of privately held interests acquired before 1. Jan. 2009 until 31. Dec. 2018
 -
- **Grandfathering of AIFM-AnpG 2013 extended till 31. Dec. 2017**
- **No further Grandfathering**

Value Added Tax

ECJ – 9. Dec. 2015 (C-595/13)

- ECJ: VAT Exemption according to Art. 135 (1) (g) VAT Directive comprises Management of state supervised real estate funds
-
- Reasoning may be transferred on all state supervised funds AIF and AIFM
- Amendment of § 4 Nr. Lit. h UStG
 - VAT-Exemption of the management of UCITS and AIFs that are comparable to UCITS
 - What means comparable?
 - comparable regulation
 - comparable investors – retail investors?
 - Applicable beginning with 1. Jan. 2018

Does it Work?



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Conference
Taxation of Funds
17.11.2016

1

**TAXATION OF COLLECTIVE
INVESTMENTS WITHIN THE
LEGAL FRAMEWORK OF STATE
AID**

**CLAIRE MICHEAU
EUROPEAN COMMISSION (BRUSSELS)
ASSOCIATE PROFESSOR**

Introduction (1)

2

- Collective investments as ever-growing tools in the internal market
- Need to comply with EU State aid rules
- Legal issues
 - To what extent can State aid law design and frame the tax regime of investment funds?

I. Brief overview of State aid rules

3

- Articles 107 to 109 TFEU
- Principle of prohibition for incompatible aid
- Criteria to qualify as State aid
- Test of selectivity
- Recovery of illegal and incompatible aid

II. Distinctive features of tax regimes of investment vehicles

4

- EU law principle of taxing undertakings for collective investments at an appropriate level.
 - Issue of additional tax layer
 - Ensuring a single taxation
- IMF guidance of taking into account the objective of “devising tax rules that are comparable to those that apply to other investments”.

III. State aid issues (1)

5

A. Investments funds performing economic activities

- Undertaking within the meaning of Article 107.
- Undertakings as entities engaged in an economic activity, regardless of their legal status and the way in which they are financed.
- Fineco case (T-445/05, Rec. 2009 p. II-289).
 - Acquiring and holding shares vs assembling and managing shares

III. State aid issues (2)

6

B. Selectivity test

1. General reference framework

- What is the normally applicable tax treatment to any investor?
- Which reference tax framework?
 - Fineco case: investment vehicles subject to the substitute 12.5% tax rate, but differential tax rate of 5% for qualifying investment vehicles.

III. State aid issues (3)

7

2. Derogation from the reference framework

- Are private investors and investment funds in a comparable legal and factual situation in the light of the objective of the tax system?
- Is the tax measure *prima facie* selective?

III. State aid issues (4)

8

3. Justification by the logic of the tax system

- Measure justified if it derives directly from the intrinsic basic or guiding principles of the reference system or being the outcome of inherent mechanisms necessary for the functioning and effectiveness of the system.
- Tax neutrality as justification ground
 - Avoiding double economic taxation
- Principle of proportionality to be respected

Conclusion

9

- Subtle context/difficulties in applying State aid rules
- Considerations on distinct legal issues brought to the fore
- Other issues to be assessed (e.g. indirect advantage/second level of beneficiary)

Thank you for your attention!

The Future of Funds Taxation **Domestic Law, Tax Treaties and EU Law**

Funds Taxation and Fundamental Freedoms

Dr. Mario Tenore, LL.M.
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Comparability analysis

- Case law: approaches to comparability
 - «*ACT GLO/Denkavit approach*»
 - «distinguishing criterion»
 - «regulatory framework»

The ACT GLO/Denkavit approach

An example: Aberdeen (i)

- § 43 “ [...] once a Member State, unilaterally or by way of a convention, imposes a charge to income tax not only on resident shareholders but also on non-resident shareholders in respect of dividends which they receive from a resident company, the position of those non-resident shareholders becomes comparable to that of resident shareholders (ACT Group Litigation, § 68; Denkavit, § 35);
- § 44 “Consequently, where a Member State has chosen to relieve resident parent companies of a series of charges to tax on the profits distributed by a resident subsidiary, it must extend that relief to non-resident parent companies which are in a comparable situation, since an imposition of that kind on those non-resident companies results from the exercise of its tax jurisdiction over them (Denkavit, § 37)”

The distinguishing criterion approach

An example: Santander case (i)

- § 27 “[...] where national tax legislation establishes a **distinguishing criterion for the taxation of distributed profits**, account must be taken of that criterion in determining whether the situations are comparable”
- § 28 “[...], only **the relevant distinguishing criteria established by the legislation in question must be taken into account** in determining whether the difference in treatment resulting from that legislation reflects situations which are objectively different”.

The distinguishing criterion approach

An example: Santander case (ii)

- Investor/shareholders' position?
 - § 28 “Accordingly, where a Member State chooses to exercise its tax jurisdiction over dividends distributed by resident companies **on the sole basis of the place of residence of the recipient UCITS**, the tax situation of the latter's shareholders is irrelevant for the purpose of determining whether or not that legislation is discriminatory”

The distinguishing criterion approach

Fidelity Funds, Case C-480/16

- *“Is a tax regime, such as that in the main proceedings, under which non-Danish undertakings for collective investment covered by Council Directive 85/611/EEC (the UCITS Directive) are taxed at source on dividends from Danish companies, contrary to Article 56 TEC (Article 63 TFEU) on free movement of capital or Article 49 TEC (Article 56 TFEU) on freedom to provide services, **where equivalent Danish undertakings for collective investment can obtain an exemption for tax at source, either because they in fact make a minimum distribution to their members in return for retention of tax at source, or technically a minimum distribution is calculated, on which tax at source is retained in relation to the undertakings’ members?**”*

The distinguishing criterion approach

- Relatively easy to be applied
- Assessment of the legal *status* of the foreign entity (investment fund v. company) still required
 - E.g. Italian legislation on taxation of foreign investment funds

The relevance of the regulatory framework Emerging Markets (i)

- What if tax residence is taken into account along with other criteria, such as the regulatory framework (e.g. UCITS vs. non-UCITS)?
- Regulatory framework:
 - UCITS Directive (applicable within the EU)
 - AIFM Directive (applicable to non-EU funds)

Relevance of the regulatory framework Emerging Markets (i)

- UCITS v. non-UCITS
 - § 67: “[...] the fact that non-resident investment funds are not part of the European Union’s uniform regulatory framework, set up by the UCITS Directive on the rules applicable to the formation and operation of investment funds within the European Union, as transposed into national law by the Polish law on investment funds, **cannot in itself be sufficient reason to find that the situations of those funds are in fact different**”

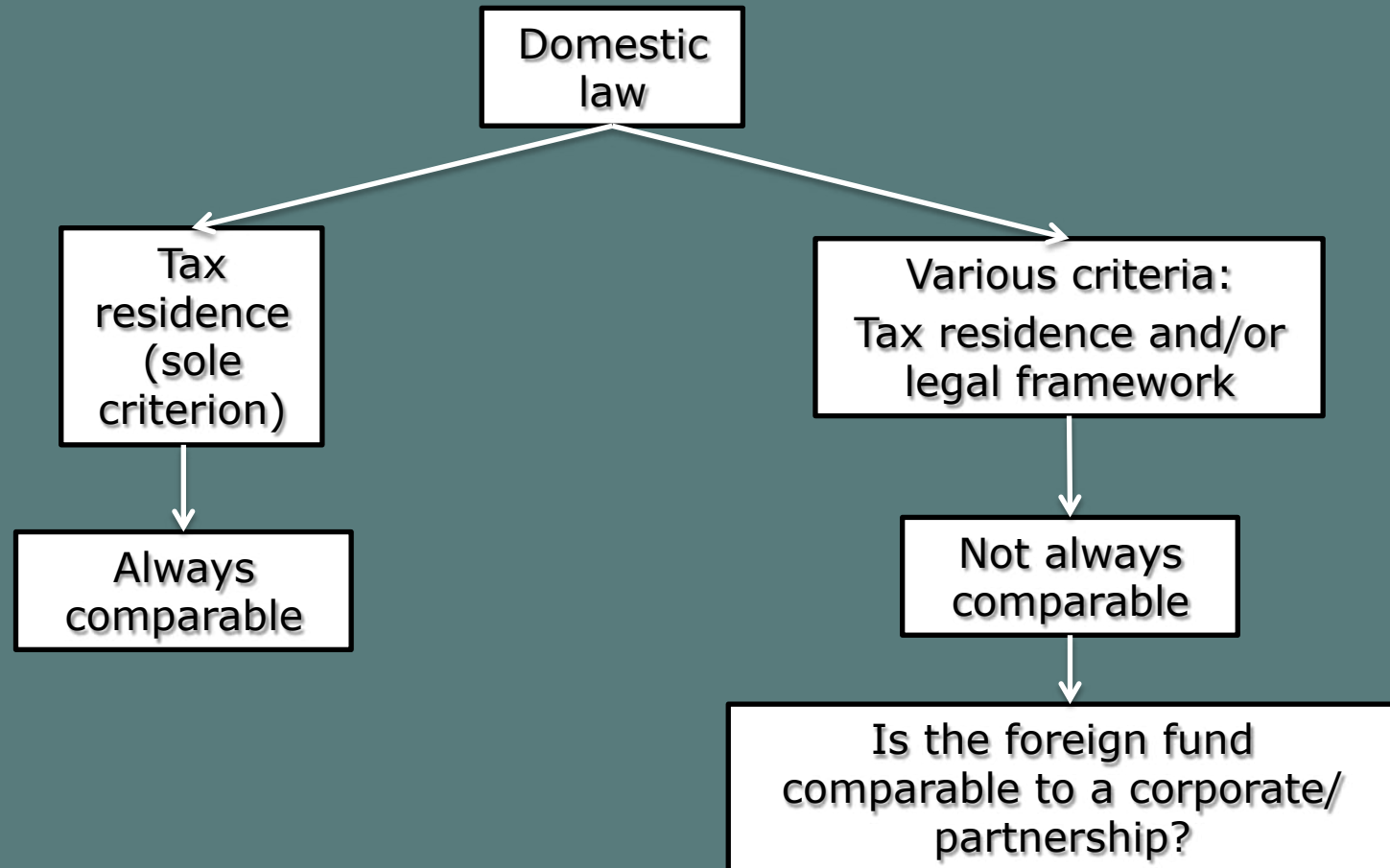
Relevance of the regulatory framework Emerging Markets (ii)

- CJEU's reasoning:
 - § 68: "[...] since the main criterion laid down by the national tax legislation at issue in the main proceedings is based on the place of residence of an investment fund, enabling solely investment funds which are established in Poland to qualify for the tax exemption, in this case a comparison of the regulatory framework governing funds established in a non-Member country and the uniform regulatory framework applied within the Union is of no relevance, in that such a comparison forms no part of the applicable legislation at issue in the main proceedings"

Relevance of the regulatory framework Emerging Markets (iii)

- Non-EU non-UCITS
 - § 67: "[...] Since the UCITS directive does not apply to investment funds established in non-Member countries, because they are outside the scope of European Union law, a requirement that such investment funds be regulated in the same way as resident investment funds **would deprive the principle of free movement of capital of any practical effect**"

Conclusions



Thank you!

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Funds and EU Tax Directives

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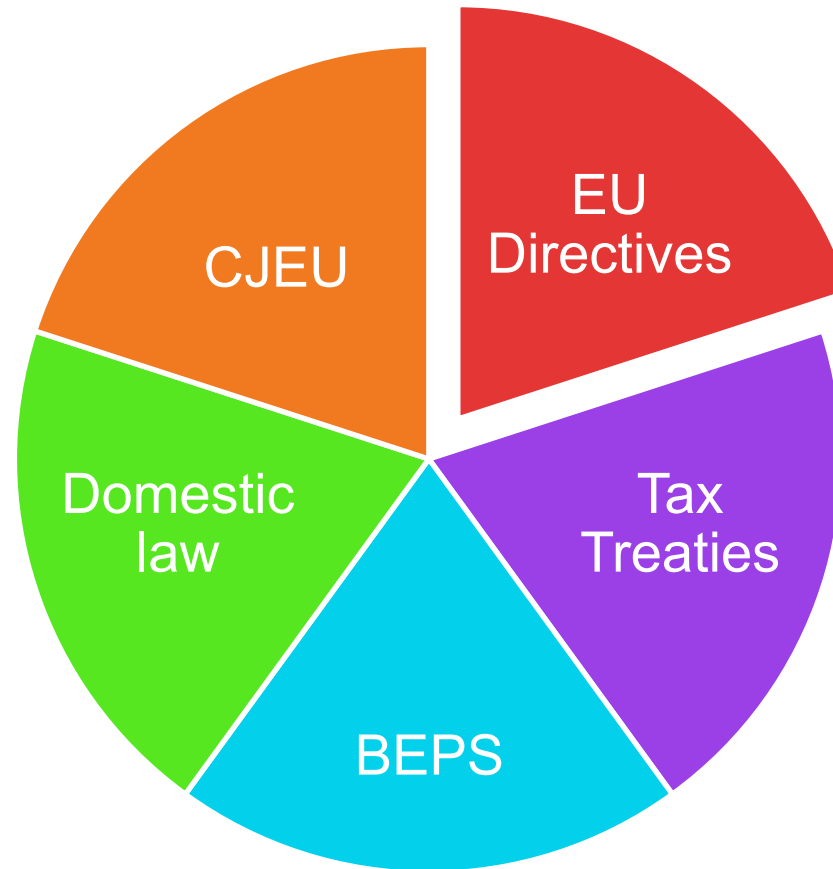
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Funds - Definitions

- No unique definition. Difficulty in grouping funds.
 - Collective Investment Vehicles vs. Non CIVs (= private equity funds, pension funds and sovereign wealth funds, real estate funds, hedge funds)
 - UCITS vs. non – UCITS (AIFMs)

Funds' treatment – solutions to problems



EU Directives: 3 ‘worlds’ – Limitations

- Finance area:
 - In the area of collective investment schemes, European law currently covers four types of harmonized investment funds:
 - UCITS (Undertakings for Collective Investment in Transferable Securities), the main European framework covering collective investment schemes that are suitable for retail investors;
 - AIFM (Alternative Investment Fund Managers), covering managers of alternative investment schemes that are addressed to professional investors;
- Funds’ specific Directives,
 - ex. IORPs (Institutions for Occupational Retirement Provisions)
 - EuVECA (European Venture Capital Funds)
- Tax area (focus on)
 - Parent –Subsidiary Directive
 - Anti-Tax avoidance Directive
 - Merger Directive

Contributions from ‘funds- specific’ directives

■ AIFM

- no reference to tax rules [Compliance with effective exchange of information - only reference art. 26 OECD MC];
- Possible impact with regard to tax residence of fund when management services move cross-border.

■ UCITS Directive

- The definition of *transferable securities* included in this Directive applies only for the purposes of this Directive and does not affect the various definitions used in national legislation for other purposes such as taxation.
- **This Directive should *not affect national rules on taxation*, including arrangements that may be imposed by Member States to ensure compliance with those rules in their territory.**
- Member States shall require that [...], the prospectus of the feeder UCITS contains the following information:
(g) *a description of the tax implications of the investment into the master UCITS for the feeder UCITS*
- Distinction between UCITS funds and non UCITS funds (ex. Real estate investment funds, private equity funds, venture capital funds, hedge funds etc.)
- Possible impact if the UCITS management transfers to another MS with respect to the tax residence of the UCITS.

■ IORP Directive: No tax rules

Most problematic areas with regard to 'funds'

- Hybrid entities, no common approach with regard to their 'type' (contract, trust, company) and hence whether they should be treated as opaque or transparent entity.
 - Treatment as a person? Resident? Beneficial owner?
 - Entitlement to tax treaty benefits?
- Problem from a tax law perspective, various levels of taxation:
 - Fund;
 - Assets/Investment property;
 - Investor.
- For tax directives purposes most common problem whether qualification as a 'company'.
 - Benefit from PSD provisions (WHT, relief from double taxation);
 - Benefit from Merger Directive (removal of obstacles, deferral of taxes);
 - 'Benefit' ('suffering') from ATAD?

Parent – Subsidiary Directive

- Qualifying entities under the Parent – Subsidiary Directive.
- Art. 2: ‘company of a Member State’ means any company which: (i) takes one of the forms listed in Annex I, Part A; (ii) according to the tax laws of a Member State is considered to **be resident in that Member State for tax purposes** and, under the terms of a double taxation agreement concluded with a third State, is not considered to be resident for tax purposes outside the Union; (iii) moreover, is **subject to one of the taxes** listed in Annex I, Part B, without the possibility **of an option or of being exempt**, or to any other tax which may be substituted for any of those taxes;
- Qualifying criteria in the Annex
 - Specific company types and
 - Residual clause: ‘Constituted under the [relevant] law’ and/or ‘subjection to tax’
 - Fiscally transparent
 - or
 - Opaque?
 - Tax exemptions?

Left to the M/S to determine.

Parent – Subsidiary Directive

- Investment funds altogether excluded from the Parent – Subsidiary Directive?
- Choice of legal form vs. subjection to corporation tax?
 - Exhaustive nature of the list? (Gaz de France, legal certainty)
 - Investment and pension funds not listed with the exception of the NL.
- Subjection to corporate tax in accordance with national law;
- Exempted companies not qualified;
- Transparent entities (without an option for corporate taxation) do not qualify (benefit from exemption)

Parent – Subsidiary Directive/Possibility to ‘come under the Directive’s scope’

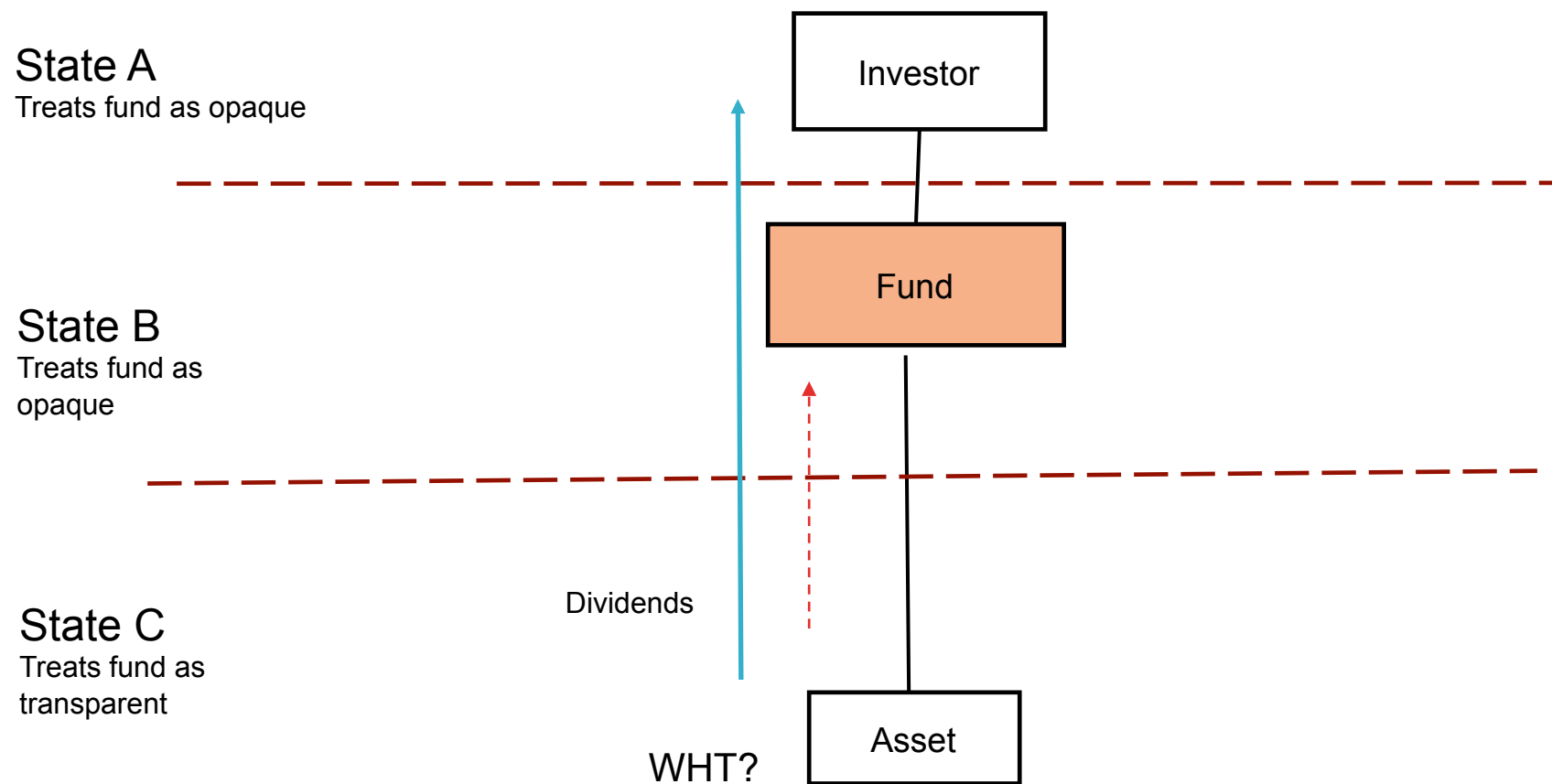
- Choice of Legal form
- The Aberdeen Case (C-303/07)
 - 26 Only for distributions of dividends within the scope of Directive 90/435 does Article 5 of that directive require the Member States to exempt from withholding tax dividends distributed by a subsidiary to its parent company.
 - 27 As the referring court observes, *the situation at issue in the main proceedings does not fall within the scope of Directive 90/435, since a company in the form of a SICAV does not satisfy the conditions set out in Article 2(1)(a) and (c) of that directive.*
 - 28 The Court has already held that, in respect of shareholdings which are not covered by Directive 90/435, it is for the Member States to determine whether, and to what extent, economic double taxation of distributed profits is to be avoided and, for that purpose, to establish, either unilaterally or by conventions concluded with other Member States, procedures intended to prevent or mitigate such economic double taxation. However, that does not of itself allow them to impose measures that are contrary to the freedoms of movement guaranteed by the Treaty (see *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 54, and *Amurta*, paragraph 24).

PSD – Hybrid entities in outbound situations

- Article 4 (2). Nothing in this Directive shall prevent the Member State of the parent company from considering *a subsidiary to be fiscally transparent [...]* and *therefore from taxing the parent company on its share of the profits of its subsidiary as and when those profits arise. In this case the Member State of the parent company shall refrain from taxing the distributed profits of the subsidiary.*
- Relief from double taxation: When assessing the parent company's share of the profits of its subsidiary as they arise the Member State of the parent company shall *either exempt* those profits or authorise the parent company *to deduct* from the amount of tax due that fraction of the corporation tax related to the parent company's share of profits and paid by its subsidiary and any lower-tier subsidiary, subject to the condition that at each tier a company and its lower-tier subsidiary fall within the definitions laid down in Article 2 and meet the requirements provided for in Article 3, up to the limit of the amount of the corresponding tax due.

PSD – Hybrid entities in inbound situations

11



Anti tax avoidance directive

- Preamble, Rec. 4: ‘ [...] it is not desirable to extend the scope of this Directive to types of entities which are *not subject to corporate tax in a Member State*; that is, in particular, **transparent entities**.’
 - Automatic exclusion of transparent entities?
 - Effectively all funds exempt?
 - Reliance on which (domestic) law?
 - What if mismatches?
- Definitions: ‘(5) ‘*financial undertaking*’: a credit institution or an investment firm [...] or an alternative investment fund manager (AIFM) [...] or an undertaking for collective investment in transferable securities (UCITS) management company [...](d) an institution for occupational retirement provision [...](5); (e) pension institutions operating pension schemes which are considered to be social security schemes [...]; an alternative investment fund (AIF) managed by an AIFM [...]; (g) UCITS in the meaning of Article 1(2) of Directive 2009/65/EC;’
 - UCITS and AIFM (UCITS and non-UCITS)
 - Coverage of many different funds.

Funds and presumption of no tax avoidance?

- ATA does not apply *to transparent entities* (effectively tax exempt - no danger for tax avoidance?)
- Investment funds as *recipients* of income
 - Strictly regulated/ obligation to keep accounts on the income they receive.
 - Most funds, in any case tax exempt, no problem with regard to tax evasion or tax avoidance.

Anti – tax avoidance Directive: Interest limitation rule

- Carve out for certain funds;
 - Interest limitation rule: [7. Member States *may exclude financial undertakings* from the scope of paragraphs 1 to 6, including where such financial undertakings are part of a consolidated group for financial accounting purposes.]
- Possibility of no exclusion ('may')? Consistency?
- Even if no carve out: most investment funds are not leveraged at the level of the fund vehicle and/or are exempt / transparent and, hence, deductibility of interest is not an issue.
- De minimis threshold of EUR 3 million.

Anti – tax avoidance Directive: Interest limitation rule

- Possibly, impact on Real Estate Investment Trusts (REITs) when generating revenue from interest through mortgage loans.
- Possibly, impact on structures *beneath the fund*.
 - Especially if operating through another company or a special purpose vehicle (SPV).
 - For instance, in cases where the SPV obtains funds *by way of debt financing*.
- Differentiation according to the ‘type’ of the fund and the funds’ investment and structuring strategies.

ATAD: GAAR (Art. 6)

- 1. For the purposes of *calculating the corporate tax liability*, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of *obtaining a tax advantage* that defeats the object or purpose of the applicable tax law, *are not genuine* having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.
- 2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.
- Possible impact if investor sets up a fund purely for tax purposes (provided all other conditions are met).
 - Possibilities to do so under domestic laws?
 - Would apply to non-UCITS and non regulated funds.
- Impact *again on the structure beneath the fund*.
 - Ex. SPV included in the fund's structure for tax purposes and have limited physical and economic substance.
 - Similar for Funds or CIVs that employ holding company structures.
 - Similar, in case of co-investment.
 - No discussion on treatment of investment funds (Tax treaty benefits: LoB or PPTs).

ATAD: Hybrid Mismatches (Art. 9)

- 1. To the extent that a hybrid mismatch results in a double deduction, the deduction shall be given only in the Member State where such payment has its source.
- 2. To the extent that a hybrid mismatch results in a deduction without inclusion, the Member State of the payer shall deny the deduction of such payment.
- Investment funds as hybrid entities. Purpose not to benefit from mismatches but hybridity due to the diversity of investors in different jurisdictions and the diversity of jurisdictions these vehicles invest in.

ATAD: Hybrid Mismatches (Art. 9)

- Possibility of double deductions
 - Ex. WHT at asset level.
 - 'Fund State' treats Fund as opaque = deduction for WHT at fund level
 - 'Investor State' treats Fund as transparent = deduction for WHT at investor level.

- Possibility of deduction without inclusion
 - Deduction at 'Asset' state.
 - 'Fund State' treats Fund as transparent
 - 'Investor State' treats hybrid/fund as opaque
 - =) deduction not included in income neither in investor State nor in Fund state.

ATA Directive : CFC rules

- Exemption of 'financial undertakings' from CFC
- Article 7 (4): Where, under the rules of a Member State, the tax base of a taxpayer is calculated according to point (a) of paragraph 2, the Member State *may opt not to treat financial undertakings as CFC* if one third or less of the entity's income from the categories under point (a) of paragraph 2 comes from transactions with the taxpayer or its associated enterprises.
- Transparent funds are not within the scope of CFC legislation because of 'flow through' basis.
- Possible impact:
 - On opaque non exempt or partly exempt funds - Ex. SICAR in Lux. (Investment company in risk capital);
 - Structures *beneath the fund* (even if funds exempt/carved out) may be treated as a CFC.
- Consistency?
 - View in relation also to the AIFM Directive.
 - Funds trading (ex. Hedge fund) through a PE in the EU?

Mergers: Cross border fund mergers

- EU Commission, White Paper on enhancing the Single Market Framework for Investment Funds, November 2006:
- “As far as *taxation* of cross-border UCITS mergers is concerned, the Commission considers it preferable to build on relevant case law of the European Court of Justice. This route seems more promising than tabling proposals for tax harmonization which will require unanimous support of 27 Member States. On the basis of European Court of Justice case-law, the Commission will come forward with a Communication to clarify that national tax-arrangements should be extended to mergers involving funds domiciled in another Member State.”

Tax Merger Directive

- Qualifying companies [*Article 3*]
- Personal Scope:
 - Legal form listed in the Annex
 - Residence for tax purposes within the EU
 - Subjection to tax pursuant to the Annex, without possibility of exemption and without possibility of an option.
- If entity meets these requirements, then it is considered a company, irrespective of the fact that a MS may classify that entity as transparent for domestic tax purposes.

Tax Merger Directive - Provisions for hybrid entities

■ Preamble, Recital 8:

- While the companies listed in Annex I, Part A are corporate taxpayers in their MS of residence, *some of them may be considered to be fiscally transparent by other MS*. In order to preserve the effectiveness of this Directive, Member States *treating non-resident corporate taxpayers as fiscally transparent should grant the benefits of this Directive to them*. However, MS should have the option *not to apply the relevant provisions of this Directive when taxing a direct or indirect shareholder of those taxpayers*.

Merger Directive – Provisions for hybrid entities

- If the state of the investor considers the non resident transferring company to be fiscally transparent, then Art. 4 [deferral of capital gains] shall apply to the shareholders to whom such gains are attributable. [Art. 4 (2)]
- Where a MS considers a *shareholder as fiscally transparent* [...] and therefore taxes those persons having an interest in the shareholder on their share of the profits of the shareholder as and when those profits arise, *that MS shall not tax those persons on income, profits or capital gains from the allotment of securities representing the capital of the receiving or acquiring company to the shareholder.* [Article 8(3).]
- If the state of the investor considers a non-resident transferring company to be fiscally transparent it may not apply the provisions of the Directive to the direct or indirect shareholders and tax the direct or indirect shareholder of that company in respect of the income, profits or capital gains of that company [subject to granting relief for tax that would have been charged by the residence state of the acquired company.] [Art. 11]

Conclusions

- 'Funds' no clear appearance in EU Tax Directives – Lacuna.
- EU legal framework very fragmented from a tax law perspective – possibility of 'clashes' with a Finance law perspective (eg. Mergers)
- Purposefully (?) funds carved out (to a large extent) from ATAD.
 - Mostly tax exempt.
- Difficulty in establishing a common legal framework because of the many possible variations with regard to the
 - Legal form and treatment of the fund;
 - The fund's investment choices;
 - The employment of holding companies or SPV beneath the fund.
- Tax law implications mostly at the level beneath the fund.
 - Dependent on the type of the fund at issue.
 - Structure and investment strategies.

Thank you!

BEPS Item 6 and Investment Fund Regulation

Prof. Dr. Dirk Zetsche, LL.M.
ADA Chair in Financial Law/
Inclusive Finance

Diverging Views on CIS

Perspective of Financial Lawyer

⇒ Use



OECD Perspective

⇒ Abuse



Overview

I. Introduction

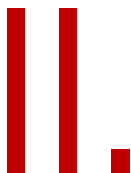
II. The OECD's approach

III. The Financial Lawyers's View on a Fund

IV. Definitional Issues in the OECD action

V. Transparency?

VI. Conclusion



The OECD's approach

OECD's Concern

- 1) non-CIV funds may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits
- 2) investors may defer recognition of income on which treaty benefits have been granted.

BEPS Action 6 *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*
Issued by Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA

Collective Investment Vehicle (OECD view)

- “collective investment vehicles” defined in 2010 OECD Report *The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles*.
 - widely-held
 - hold a diversified portfolio
 - of securities
 - subject to investor-protection regulation in home country
 - manager of the CIV has discretionary powers to manage the assets
- ≈ UCITS and UCITS equivalent
(OECD 2010, ¶133)

OECD does not define „non-CIV“

- No one knows what they talk about
- Many aspects mixed together
- As of now undue legal uncertainty
- Objective: further certainty, with a focus on Undertakings for Collective Investments (‘UCIs’)

2010 CIV report ↔ AIFMD

- Requirements in 2010 CIV report
 - manager of the CIV has discretionary powers to manage the assets (+)
 - limiting the use of leverage (+, by NCA rather than fixed limit)
 - widely-held (not required by AIFMD)
 - hold a diversified portfolio (concentration of investments allowed; ELTIFR?)
 - of securities (all asset classes allowed)
 - subject to *investor-protection* regulation in home country (AIFMD tbd)
 - restricting acquisition of controlling interests (↔ private equity?)

⇒ Non-CIV relevant for all AIF and domestic sub-AIF legislation

Focus: Regulatory Aspects of OECD DD

- Focus: Financial Law aspects
 - ⇒ Definitions
 - ⇒ Concept of Transparency
 - ⇒ Information flow

- Not addressed in this presentation
 - ⇒ Technical tax issues
 - ⇒ Cross-border tax laws
 - ⇒ DTA matters



The Investment Fund (from a FL's view)

CIS Intermediary Chain

Asset Owners

- Private Investors
(retail, HNWi)
- Professional Investors
(Pension Schemes, Insurance Undertakings, Banks, Investment Firms)

Collective
Investment
Schemes

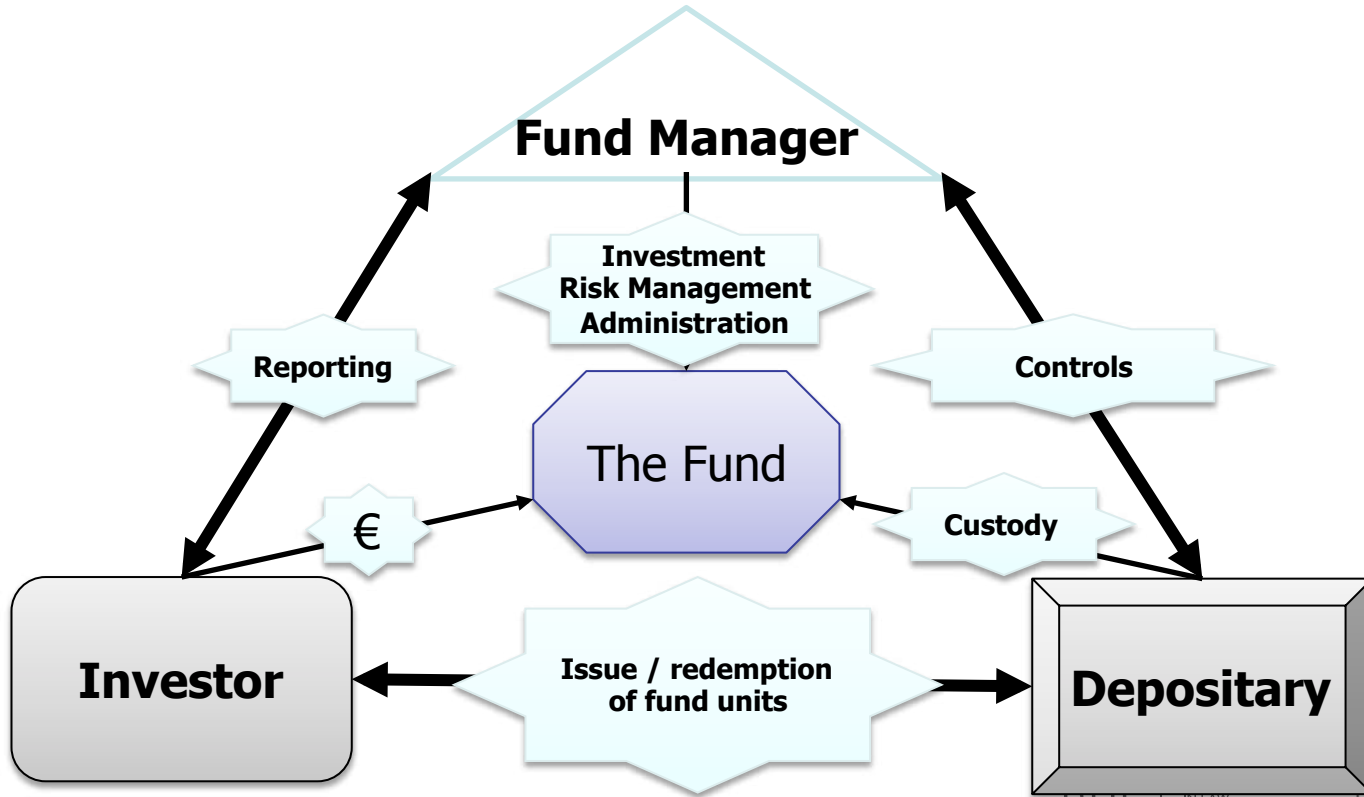
Capital Demand

- SMEs
 - Infrastructure
- Mature Business

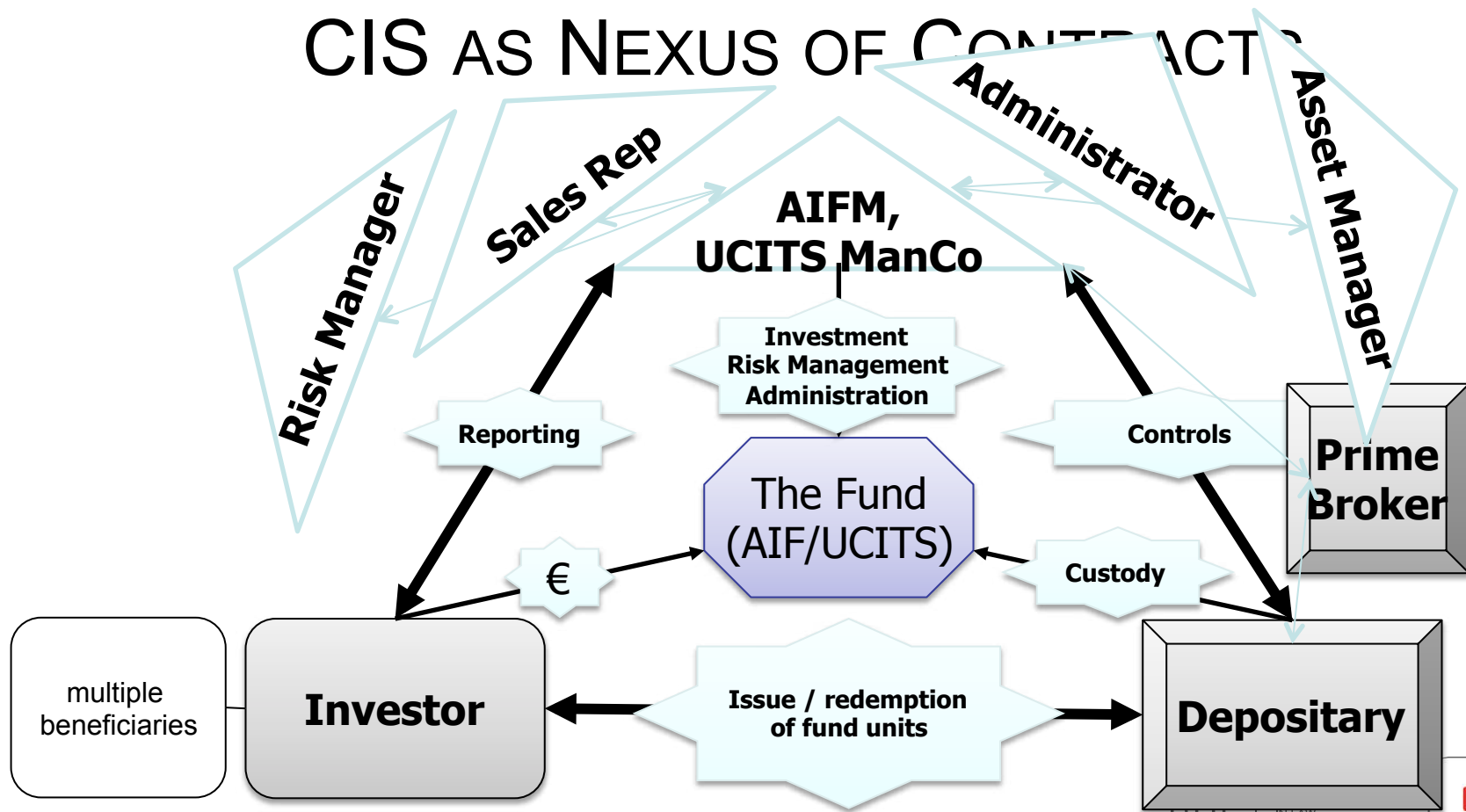
A fund from FL's view (1)

- functional network of contracts
- set up and run by expert intermediaries

CIS INVESTMENT TRIANGLE



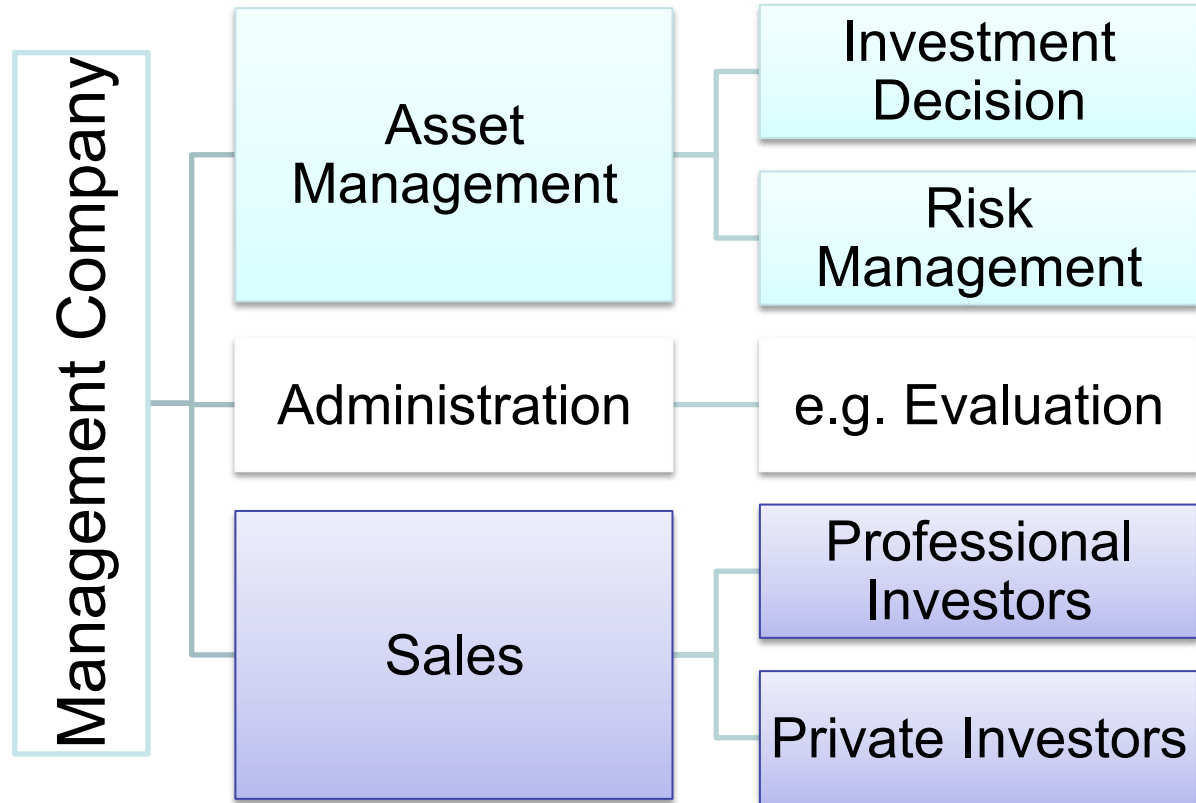
CIS AS NEXUS OF CONTRACTS



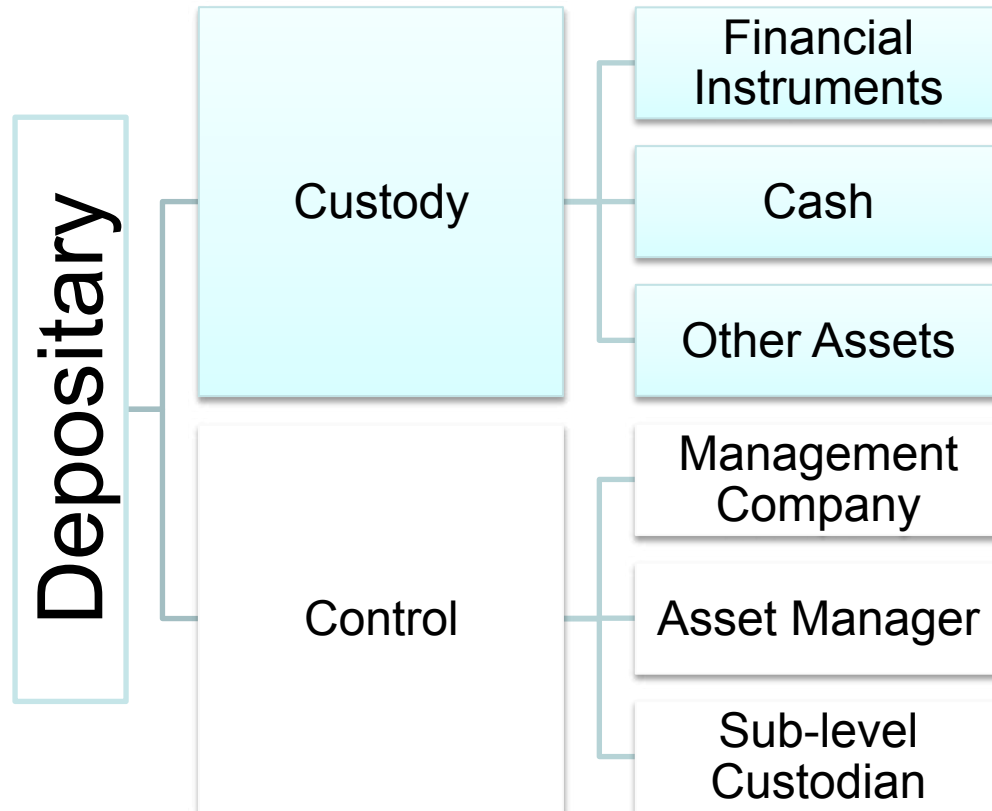
A fund from FL's view (2)

- set up and run by expert intermediaries
 - requires sufficient expertise and resources at the
« effective place of (asset, risk and fund) management »
- => Minimum substance requirements in fund regulation!

Management Company



Depository



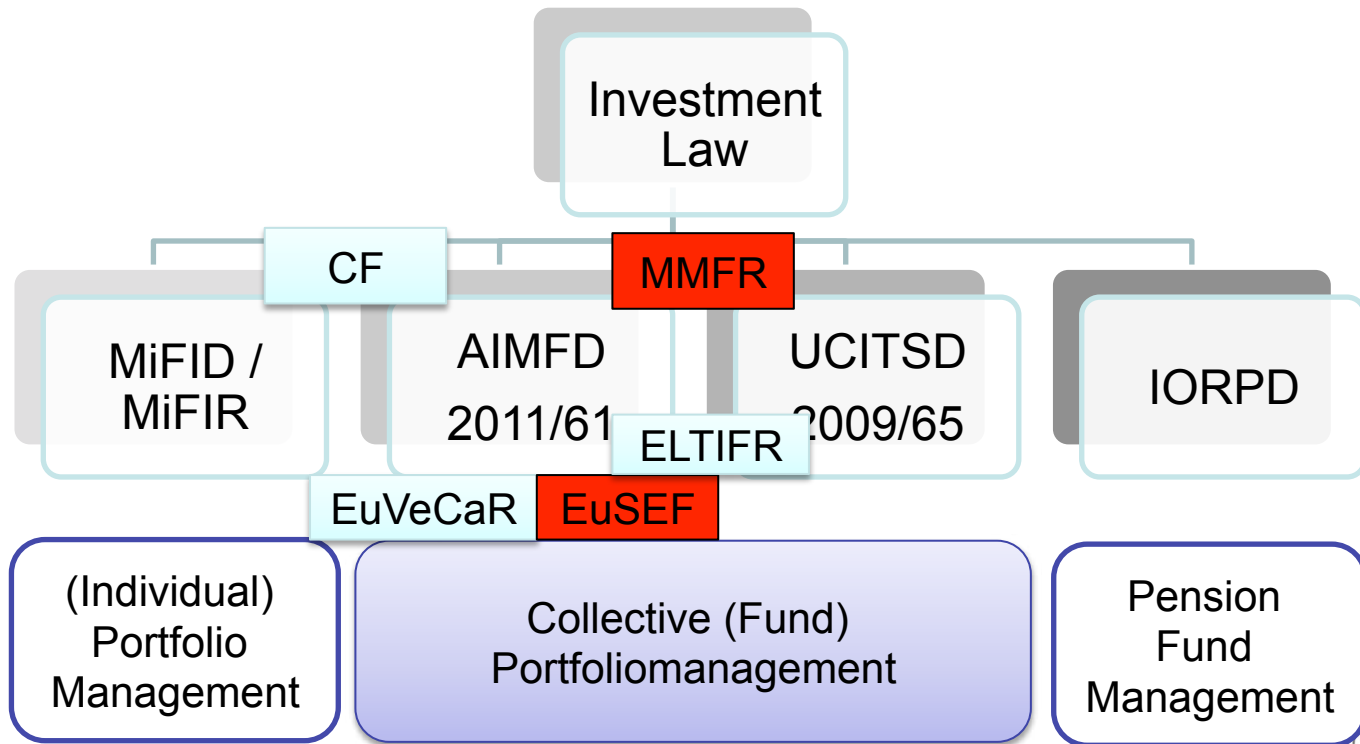
A fund from FL's view (3)

- limited liability, protection of investors, best possible control of intermediary's agency costs
- optimized for non-active (“passive”) investors
- system of checks and balances: manager ↔ depositary

A fund from FL's view (4)

- European fund legislation: « functional approach »
- legal form for the most part irrelevant (corporate, partnership, contract, trust, even associations)

European Investment Law



IV.

OECD's definitional approaches

OECD looking for legal certainty

- Context: delineating « good » from « bad » non-CIV (bad entities not entitled to treaty benefits)
- Non-CIV restricted for institutional investors only (« professional investor funds », special funds (but wider) pp.)

1. Institutional Investors

- OECD does not define « non-CIV » itself
- (but) OECD requires definition of institutional investors
 - European terms professional client (MiFID), professional investor (AIFMD)
- Related OECD question: Do institutional investors generally benefit from treaty benefits? Do they structure less often? Pp.

FL's Definition of Institutional Investors

- Institutional investors not defined by European FL, but binding list of examples in Annex II MiFID
- **Entities required to be authorised or regulated to operate in the financial markets in EU/EEA or TC**
 - Credit institutions (CRD)
 - Investment firms (MiFID)
 - Other authorised or regulated financial institutions (Member State level)
 - Insurance companies (EIOPA)
 - CIS and management companies of such schemes (UCITS, AIFM)
 - Pension funds and management companies of such funds
 - Commodity and commodity derivatives dealers (MiFID)
 - Locals (MiFID)
 - Other institutional investors (discussion re Family Offices, SWFs)

2. Bone fide investment objective

- Equivalent in Financial Law: « investment » vs. « operating business », or in US terminology « securities »
- Difficult, long discussion for many years, but on most cases clarity
- Remaining issue: non-controlling holding – operating business or fund?

3. Marketed to a diverse investor base

- Not an acceptable criterion of CIS definition, only for UCITS (« marketed to the public »)
- Accepted criterion for application of disclosure and distribution rules, in particular the Prospectus Directive
- Threshold varies, usually marketing to 100/150 people plus
- Distribution approach does not tell anything about number of investor in the fund
- Inadequate for OECD purposes

4. Limits on use of derivatives

- OECD : derivatives used for swapping income rather than risks
 - UCITS (+); AIFMD: (-), hedging and speculation allowed
 - No issue if third party manager truly manages fund with a view to investment performance
 - Can become an issue if investor manages directly or has undue influence over the third party manager
- ⇒ Concerns in this case tax and fund law

5. Number of investors / „widely held“

- OECD considerations include holding limits of 10%: 10 investors
- Financial law liberal
 - AIF: one investor if fund documents allow for other investors to invest
 - Some domestic fund laws provide for special regimes including Single Investor Funds
 - Single Investor Funds \neq Collective Investment Schemes, but often used for collective purposes (insurance, families = multiple « beneficiarires »)

⇒ Conflict FL / TL predictable

- « True » influence on fund manager? Who calls the shots?

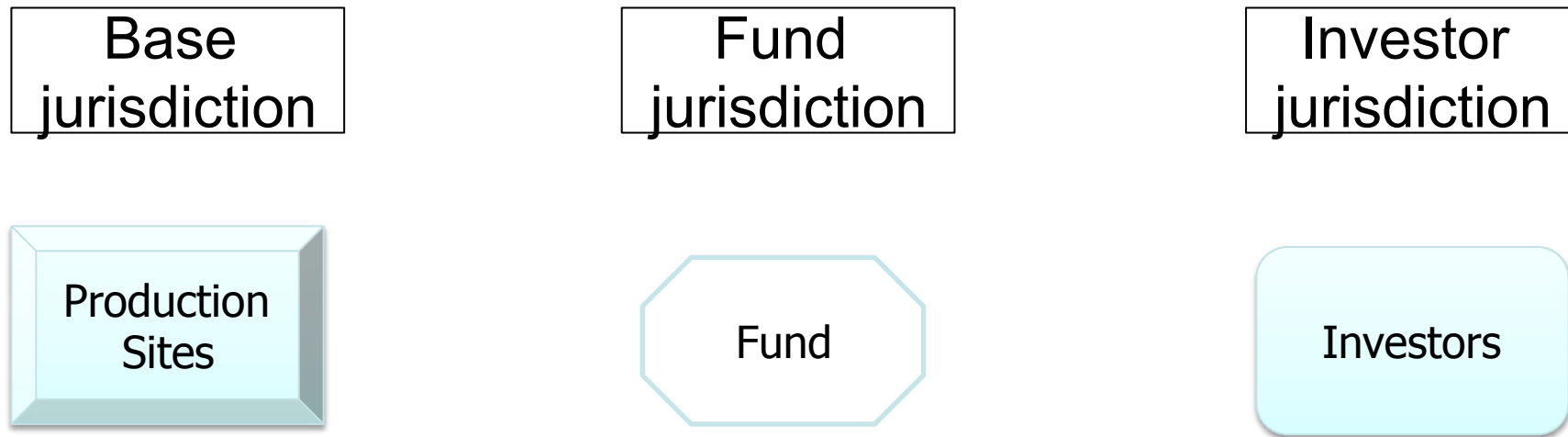
V.

Transparency

TP in the OECD Context

- Suggestion re Limitation-of-Benefits provisions
- Subject to restrictions regarding the recipient
- Result: Focus on tax structuring on base and investor jurisdiction
- OECD questions relate to practicability

Setting the stage



Note: 'the fund' is a different entity than the investment company, i.e. the carrier of the fund

Financial lawyer's / board members' view on TP?



Simplify
your fund!

- Tax-driven structures create distortions
 - ❑ Costs
 - ❑ Interference with objectives of financial law; example: risk management and board control weakened by tax-driven intermediary holdings between fund and base investment
 - ❑ Different considerations than “investors’ best interest regarding the investment performance” may prevail
 - ❑ Could facilitate undue hoarding of cash / cash equivalents – good for fund manager, not so good for investors

Arg contra TP: Information Flow?

- ‘Fund does not know its investors’
- ‘Information flow not feasible in intermediary chain’
- Pp.

⇒ ... but it works with some UCITS

Arg contra TP: Information Flow?

- (1) Make adequate information flow an investment requisite
- (2) Require all intermediaries involved in the fund to support information flow
- (3) Give time
- (4) Let FinTech do the rest

Transparency – Special Cases

- Single transparent structures
 - E.g. securitisation company cannot identify its bondholders (not UCITS, AIF issue!)
- ⇒ Registered shares or other way to identify bondholders through bank intermediary chain as prerequisite for TP
-
- Double Transparent Structures
 - Fund of Funds
 - Financial institution investing in CIS *on behalf of its own clients* or structured investments which it sells to its clients
- ⇒ 2nd intermediary must provide data or may not invest in (1st) transparent vehicle

TP - Beneficial Ownership Chain

- Where money (dividends!) find its way in the one direction
information could do the other way around
⇒ Information flow *could* be achieved the same way as outlined

TP - Beneficial Ownership Chain

- But: *Shall* it be required?
- Data protection concerns: all investment data of all investors worldwide flowing around in data centers of the world;
 - ⇒ access by NSA, KGB, ISIS?
- Consider IAA environment: Income declaration lesser concern (here banks provide for account statements incl. non-domestic income and investors)
 - ⇒ Different treatment for IAA members and non-members warranted
 - ⇒ Allocate additional costs to nationals of non-IAA states only, for instance with separate feeder funds

Conclusions

- 1) OECD's pure tax lawyer's views blurs concepts, questions and indicated conclusions. Financial law definitions could help. Closer alignment of tax and regulation necessary.
- 2) Concerns of financial and tax laws are closer than some would think. A fund "managed" by investors, a fund manager without "substance" and overly tax-driven structuring are concerns both for tax and financial law.
- 3) Advanced AML rules, KYC and automatic information exchange enable information flow sufficient for a 'transparent' regime; for the rest: FinTech!
- 4) OECD-style (country by country) tax agreements are harmful to completion of Single Market and competition on the merits. A harmonized European tax regime for UCITS and AIF would be preferable. Could include Transparency or Taxable Entity with full exemption approach.

Thanks!

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Treaty Entitlement of Funds in a Pre-BEPS World

Daniel Dürrschmidt

Treaty Entitlement of Funds in a Pre-BEPS World

1. Introduction

2. Overview of the Application of Tax Treaties to CIVs

a) General Remarks

b) Personal Scope of Application (“Treaty Entitlement”)

c) Distributive Rules, including “Beneficial Ownership” concept

d) Methods for the Avoidance of Double Taxation

Treaty Entitlement of Funds in a Pre-BEPS World

Art. 1 of the OECD MC:

“This Convention shall apply to persons who are residents of one or both of the Contracting States.”

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Art. 10 of the OECD MC (simplified):

“(1) Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

(2) However, dividends paid by *a* company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

- a) 5 per cent of the gross amount of the dividends if the beneficial owner is *a* company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;
- b) 15 per cent of the gross amount of the dividends in all other cases”.

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Art. 23A (1) of the OECD MC (simplified):

“Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.”

Art. 23B (1), sentence 1 of the OECD MC (simplified):

“Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow:

a) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State; [...]”

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Treaty Entitlement of Funds in a Pre-BEPS World

3. “Treaty Entitlement” of a CIV under General Tax Treaty Provisions

- a) General Remarks
- b) CIV as a “Person”
- c) CIV as a “Resident of a Contracting State”
 - aa) Transparent and Non-transparent Vehicles
 - bb) Tax Exemption
- d) “Treaty Entitlement” of Investors

Treaty Entitlement of Funds in a Pre-BEPS World

Art. 3(1)(a) of the OECD MC:

“The term “person” includes an individual, a company and any other body of persons.”

Art. 3(1)(b) of the OECD MC:

“The term “company” means any body corporate or any entity that is treated as a body corporate for tax purposes.”

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Treaty Entitlement of Funds in a Pre-BEPS World

Art. 4(1), sentence 1 of the OECD MC:

“For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature [...].”

Art. 4(1), sentence 2 of the OECD MC:

“This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.”

Treaty Entitlement of Funds in a Pre-BEPS World

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Treaty Entitlement of Funds in a Pre-BEPS World

4. Special Tax Treaty Provisions for CIVs related to “Treaty Entitlement”

- a) General Remarks
- b) Content of Special Tax Treaty Provisions
- c) Weaknesses of Special Tax Treaty Provisions for CIVs, illustrated in the Tax Treaty between Germany and Luxembourg

5. Conclusion

Treaty Entitlement of Funds in a Pre-BEPS World

Protokoll

1. Zu dem Abkommen insgesamt

„(1) Ein nach dem Recht eines Vertragsstaates gebildetes Investmentvermögen, das aus dem anderen Vertragsstaat stammende Dividenden oder Zinsen bezieht, kann die in den Artikeln 10 und 11 dieses Abkommens vorgesehenen Beschränkungen des Besteuerungsrechts des anderen Vertragsstaats geltend machen, soweit die Anteile an dem Investmentvermögen von in dem erstgenannten Staat ansässigen Personen gehalten werden. Mit Anerkennung eines Anspruchs des Investmentvermögens erlischt das Recht der Anteilscheininhaber an diesem Investmentvermögen, einen Anspruch auf dieselbe Vergünstigung geltend zu machen.

Im Sinne dieser Bestimmung bedeutet Investmentvermögen

- a) in der Bundesrepublik Deutschland ein durch eine Kapitalanlagegesellschaft verwaltetes Sondervermögen im Sinne des Investmentgesetzes,
- b) in Luxemburg ein Investmentfond (fonds commun de placement).“

Treaty Entitlement of Funds in a Pre-BEPS World

Protokoll

1. Zu dem Abkommen insgesamt

„(2) Investmentgesellschaften können die in Artikel 10 und 11 vorgesehenen Beschränkungen selbständig geltend machen.

Im Sinne dieser Bestimmung bedeutet Investmentgesellschaft

- a) in der Bundesrepublik Deutschland die Investmentaktiengesellschaft
- b) in Luxemburg
 - die Risikoanlagegesellschaft (société d'investissement en capital à risque [SICAR]),
 - die Anlagegesellschaft mit variablem Kapital (société d'investissement à capital variable [SICAV]) und
 - die Anlagegesellschaft mit festem Kapital (société d'investissement à capital fixe [SICAF]).

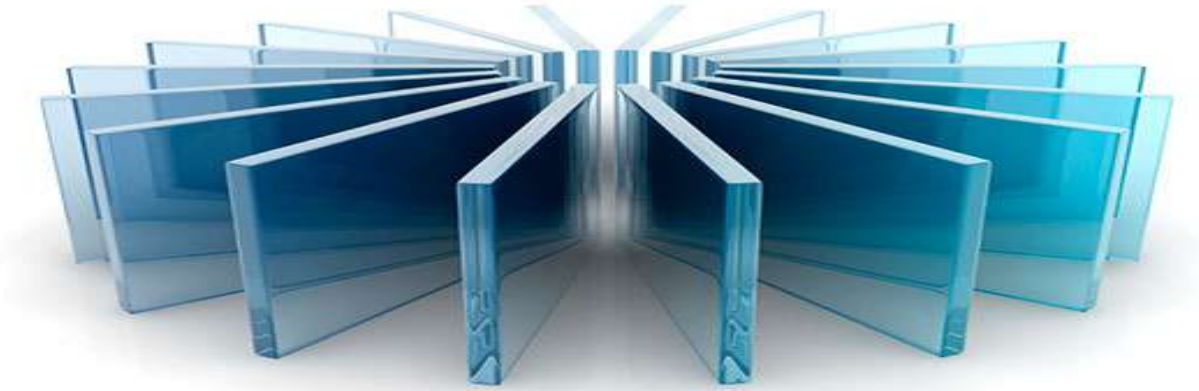
Die zuständigen Behörden können die Einzelheiten zur Durchführung dieser Bestimmung in gegenseitigem Einvernehmen regeln, um sicherzustellen, dass aufgrund dieser Bestimmung keine unberechtigten Erstattungen erfolgen. “

Treaty Entitlement of Funds in a Pre-BEPS World

4. Special Tax Treaty Provisions for CIVs related to “Treaty Entitlement”

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- b) Content of Special Tax Treaty Provisions
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Funds in International Tax Law: examples from Luxembourg's Treaties

Jean Schaffner

17 November 2016

1. Basic tax regime of funds

- No income tax, no wealth tax, annual subscription duty
- Opaque and tax transparent funds
- Distinct from (i) unregulated funds (Soparfis, even if qualifying as AIF), (ii) SICARs (and SVs) and (iii) partnerships
- Extension to new vehicles (RAIF – Reserved Alternative Investment Funds)?

2. Basic rules for treaty access

- Person
- Residence: liable to tax
- Specific rules:
 - LOB
 - Anti-abuse rules : F - Lux treaty
 - Tax transparent funds (such as Luxembourg *fonds commun de placement*)
 - Different analysis of tax transparency possible
 - Direct access to members?
 - How is treaty access evidenced?
 - How is treaty benefit shared among investors?

3. Traditional Luxembourg approach

- SICAVs fall within scope of income tax, although benefiting from a specific, subjective tax exemption
- Alternative approach could have been that subscription tax is a wealth tax, creating tax liability
 - But historically it is a tax on negotiation of shares
- Luxembourg tax authorities have established a list of countries offering treaty protection (Circulaire L.G. - A n° 61 of 12 February 2015, which is regularly updated)
 - ➡ Does not mean 0% WHT!
 - Based on bilateral negotiations
 - No common denominator, nor objective justification in wording of tax treaties (example: Irish DTT: application of treaty for FCP and SICAV, despite silence of treaty)
 - Certain treaties have a specific exclusion for holding companies, extended to investment funds (similar tax regime; e.g. Canada, Switzerland)
- Delivery of residence certificates (tax office 6) - it may be complex to obtain WHT refunds

4. New approach based on revised OECD MC

- Does not cover taxation of funds themselves nor of resident investors, only source taxation
- Treaty access to funds favors small investors
- Two possible approaches
 - Grant direct treaty access to funds (n° 6.17 of commentaries on article 1): assimilated to individual
 - Renegotiation v.s. mutual agreement procedure
 - Publicly traded funds (n° 6.32 of commentaries on article 1): no treaty shopping
 - Offer reduced WHT on a look through basis, to the extent fund has local investors
 - Applies not only to tax transparent funds (proportionate application of DTT)
 - Unsatisfactory for Luxembourg, given the investor base (direct treaty access is more satisfactory)
 - Complicated and unequitable
 - Changes of investor base during a fiscal year
 - Possible extension to investors from third countries which would be treated in an equivalent manner to resident individuals in case of direct investment
 - ❖ Combined with exchange of information provision
 - Alternatively fund may claim treaty protection on behalf of the investors directly

5. Examples of current Luxembourg treaty approach

Andorra, Guernsey, Jersey, the Seychelles, Croatia, Taiwan, Sri Lanka and the **Isle of Man** have the following provision in their respective protocols : (i) the protocol with the **Isle of Man** adds one sentence at the end of the first paragraph, in **blue** and (ii) the protocol of the treaties with **Taiwan** and **Sri Lanka** is limited to the first paragraph, in **green**. Furthermore, Taiwan uses the notion of *territory* instead of *contracting party*.

A collective investment vehicle which is established in a Contracting Party and that is treated as a body corporate for tax purposes in that Contracting Party shall be considered as a resident of the Contracting Party in which it is established and as the beneficial owner of the income it receives.

A collective investment vehicle which is established in a Contracting Party and that is not treated as a body corporate for tax purposes in that Contracting Party shall be considered as an individual who is resident of the Contracting Party in which it is established and as the beneficial owner of the income it receives. *However, this provision shall not prevent the other Contracting Party from taxing its residents if they receive income from such a collective investment vehicle (Isle of Man).*

Saudi Arabia and Tajikistan DTTs use the following provision:

A collective investment vehicle which is established in a Contracting Party is considered a resident of that Contracting party where it is established and the beneficial owner of the income it receives.

 Would include SICAV(F) and FCP

Singapore: it is understood that a collective investment vehicle is a resident of a Contracting State if under the domestic laws of that State it is liable to tax therein by reason of its domicile, residence, place of management or any other criterion of a similar nature. A collective investment vehicle is also considered liable to tax if it is subject to the tax laws of that Contracting State but is exempt from tax only if it meets all the requirements for exemption specified in the tax laws of that Contracting State.

The **Czech Republic** treaty uses the following provision:

For the purposes of the first sentence of paragraph 1 of Article 4, it is understood that the term "resident of a Contracting State" also includes a fiscally non-transparent person (including a collective investment vehicle) that is established in that State according to its laws even in the case where the income of that person is taxed at a zero rate in that State or is exempt from tax there.

Estonia: SICAV(F), SICAR and FCP are listed as residents.

Germany has the most detailed provision (see also Circulaire L.G. – Conv. D.I. n° 58 of 9 February 2015):

- ❖ An investment fund constituted under the law of a Contracting Party which receives dividends or interest derived from the other Contracting State may invoke the restrictions of the tax legislation of the other Contracting Party provided for in Articles 10 and 11 of this Agreement to the extent that the units of the fund are held by the first mentioned State's residents. With the recognition of a claim by the investment fund, the right of the shareholder of the investment fund to claim the same benefit ceases.

For the purposes of this provision, investment fund means

- (a) in the Federal Republic of Germany, a fund managed by an investment company in the sense of the law for investments,
- (b) in Luxembourg an investment fund (*fonds commun de placement*).

- ❖ Investment companies may independently benefit from Articles 10 and 11.

For the purposes of this provision, investment company means

- a) the investment company in the Federal Republic of Germany
- b) in Luxembourg
 - the investment company in risk capital (*Société d'investissement en Capital à risque* [SICAR]),
 - the investment company with variable capital (*Société d'investissement à capital variable* [SICAV]);
 - the investment company with fixed capital (*Société d'investissement à capital fixe* [SICAF]).

 Reduced WHT rates

Spain

Circulaire L.G. – Conv n° 52 of 21 July 2015: only SICAVs under part I (coordinated SICAVs) can benefit to treaty access, other SICAVs are assimilated to SPFs.

6. Possible outlook

- Create tax charge on a reduced basis
 - Such as for Belgian SICAVs
 - Recognized by Luxembourg tribunals
 - State aid criticism?
- Change the nature of subscription tax
 - ❖ Certain treaties do not include NWT
- Equal treatment at EU level
 - Prohibition to discriminate foreign EU funds → treaty access (or availability of domestic exemption)

Questions?

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Non-Discrimination of Funds and Double Taxation Relief

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Presentation of the problems

› **Funds are generally non-taxable entities under domestic law**

- Either because corporate income tax applies at a zero rate
- Or because they are transparent for tax purposes

› **Withholding taxes on payments made to non-resident funds may however be levied**

- Because domestic law may not provide for specific exemptions for non-resident funds
- ... and distributive rules in tax treaties do not eliminate the WT
- → from the perspective of the source State, discrimination occurs

› **If a fund receives income from a foreign source, double taxation must be relieved**

- but the relief may be granted in a discriminatory way if investors are non residents
- → from the perspective of the residence State (of the fund), discrimination occurs as well



I- The perspective of the source State

Is article 24 OECD Model applicable?

- › **If the source State is a member of the EU**, freedom of capital movement applies → problem generally solved through extension of exemption
 - see ECJ, 10 May 2012, C-338/11 to C-347/11, *Santander Asset Management SGII SA*

- › **If the source State is a third country**
 - What causes discrimination ?
 - The source State does not apply the Treaty exemption (if any) because it denies treaty benefits to non-resident funds
 - OR the source State applies treaty benefits to non-resident funds but the WT is > 0 while a comparable fund having its residence in the source State would have been tax exempt

Is article 24 OECD Model applicable?

- › **Problem n° 1 : is it possible to apply Article 24 although funds may not be eligible to tax treaty benefits?**
- Art. 24. 1 : Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.
- Here : funds may not be residents, but as long as they are “nationals” of the other Contracting State, art. 24 should apply

Is Article 24 OECD Model applicable?

› Problem n° 2 : are funds « nationals of a Contracting State »?

- Art. 3. 1 i g) OECD Model : the term “national”, in relation to a Contracting State, means:
 - (i) any individual possessing the nationality or citizenship of that Contracting State; and
 - (ii) any legal person, partnership or association deriving its status as such from the laws in force in that Contracting State
- Ex. drawn from French case law on pension funds
 - Adm. Court of Appeal of Paris, 6 Dec. 2007, n° 06-3370 : Stichting Unilever Pensioenfond Progress ; later confirmed by Adm. Supreme Court
 - Capital gain on immovable property taxed at a discriminatory rate
 - Art. 25.3. of tax treaty between France and the Netherlands
 - Reasoning of the Court : Art. 25.2. worded after OECD Model

Comparability between resident and non-resident funds

- › **Art. 24. 1** : Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected
 - Commentary, § 7 : The expression “in the same circumstances” refers to taxpayers (individuals, legal persons, partnerships and associations) placed, from the point of view of the application of the ordinary taxation laws and regulations, in **substantially similar circumstances both in law and in fact**.
 - Commentary, § 17 : Since paragraph 1 of Article 24 prevents different treatment based on nationality but only with respect to persons or entities “in the same circumstances, in particular with respect to residence”, it is therefore important to distinguish, for purposes of that paragraph, a **different treatment that is solely based on nationality** from a different treatment that relates to other circumstances and, in particular, residence.

Comparability between resident and non-resident funds

› **Step n° 1 : assess whether non-resident and resident funds are comparable by nature**

- Methodology :
 - Start with legal features of resident tax-exempt funds : regulatory requirements, open-ended/closed-ended, investment risk profile, types of assets invested in...
 - See whether these features are broadly possessed by non-resident funds in the light of the objective pursued by the domestic legislator
 - Comparability does not mean identity
 - See ECJ, Emerging Markets (M. Tenore)
 - French Adm. Supreme Court, 22 May 2015, n° 369819, *Wellcome Trust*
 - Decision based on EU law, not tax treaties ; pension fund
 - Although French criteria require that no remuneration is paid to the managers of the non for profit entity, a non-resident entity may be regarded as non for profit if the remuneration paid to its managers is not disproportionate (considering their duties and liabilities)

Comparability between resident and non-resident funds

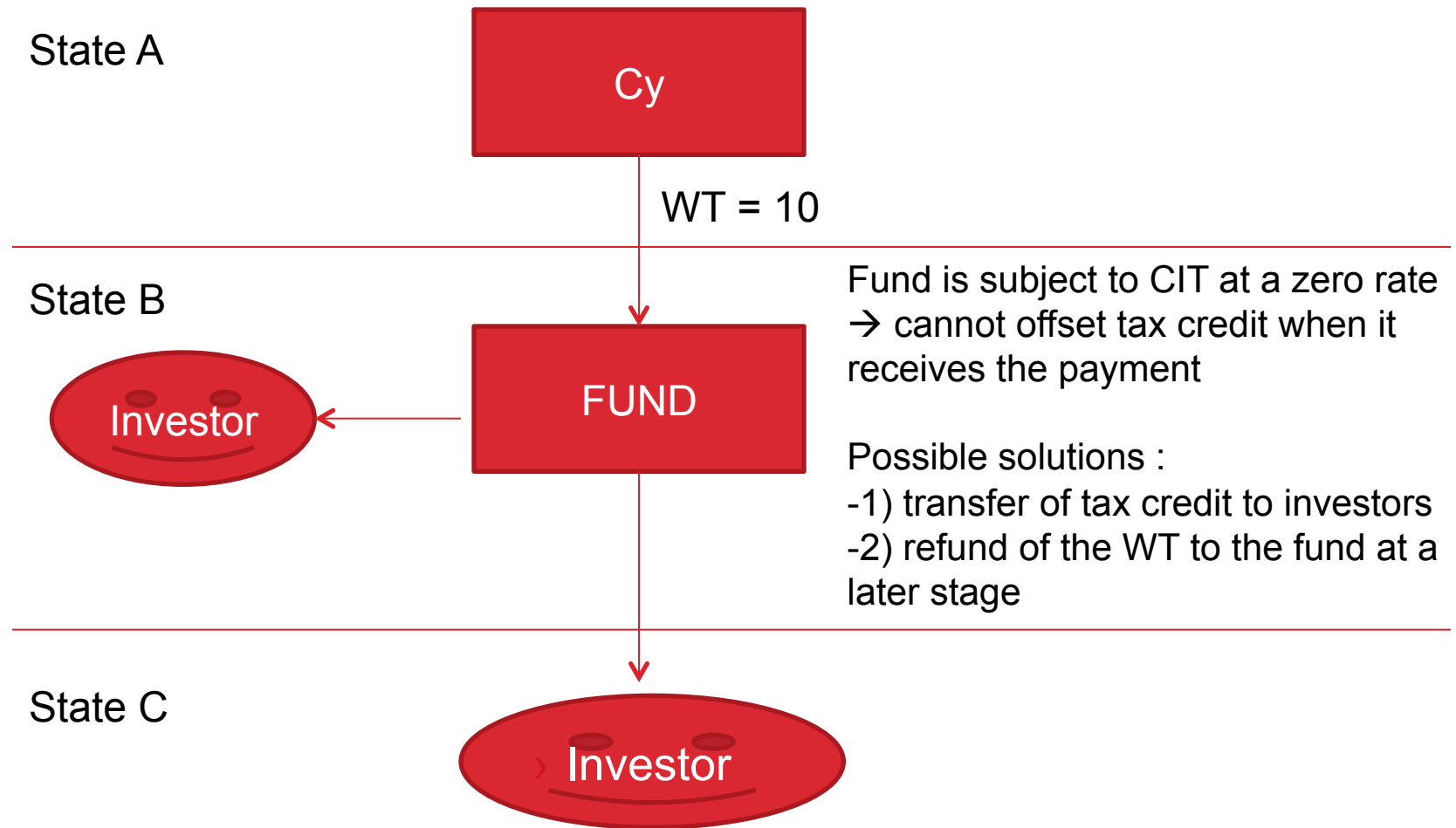
› **Step 2 : make sure that the different tax treatment is solely based on nationality**

- Possible discussion on this issue
- But see French case law where for the purposes of Article 24 (when applicable to funds), nationality and residence converge
 - Nationality of legal entities is based on « real seat » theory → place of effective management is not different from nationality, both under domestic law and under Article 24 (CE, 5 July 2010, n° 309693, *Pinacothèque d'Athènes* (+ earlier judgments))
- Alternative argumentation possible based on non-discrimination principle in ECHR (art. 14 + art. 1 of first protocol)?
 - In French case law, precedents of bilateral tax treaties considered contrary to ECHR...



II- The perspective of the residence State

Description of the problem



Transfer of tax credit to investors

› If the investor is a resident of State B

- The tax credit is normally equal to the tax credit which the investor would have enjoyed if he had received the income directly from State A
- The investor may invoke the tax treaty between State A and State B

› If the investor is a resident of State C

- Either State B takes a « flow-through approach » → does not levy any tax upon distribution to the investors of State C (on the ground that income is deemed to flow directly from State A to State C)
 - → no problem : investors of State C are not worse off than investors of State B (at least from the perspective of State B)
- Or State B levies a WT (for instance 15) on distributions to investors
 - State B may allow to reduce the WT up to the initial tax credit : $15 - 10 = 5$ (no discrimination)
 - State B may not allow to reduce the WT up to the initial tax credit : **discrimination with residents of State B**

Transfer of tax credit to investors

- › **Is discrimination in this situation contrary to Article 24 OECD Model?**
 - Applicable tax treaty : B→C treaty because B discriminates payments by resident funds according to the residence of the investors (in B or in C).
 - So B must apply Art. 24 as the source State
 - Additional observation :
 - in some cases, the treaty between A and B provides for a transfer of the tax credit to investors ;
 - But the treaty only provides for such a transfer to investors of State B (i.e. having their residence in the same State of the fund)
 - So even though the A/B treaty provides for this transfer, B can be criticized under Art. 24 of the B/C treaty for not allowing this transfer to residents of State C
 - Main problem : is this really discrimination on the basis of nationality?

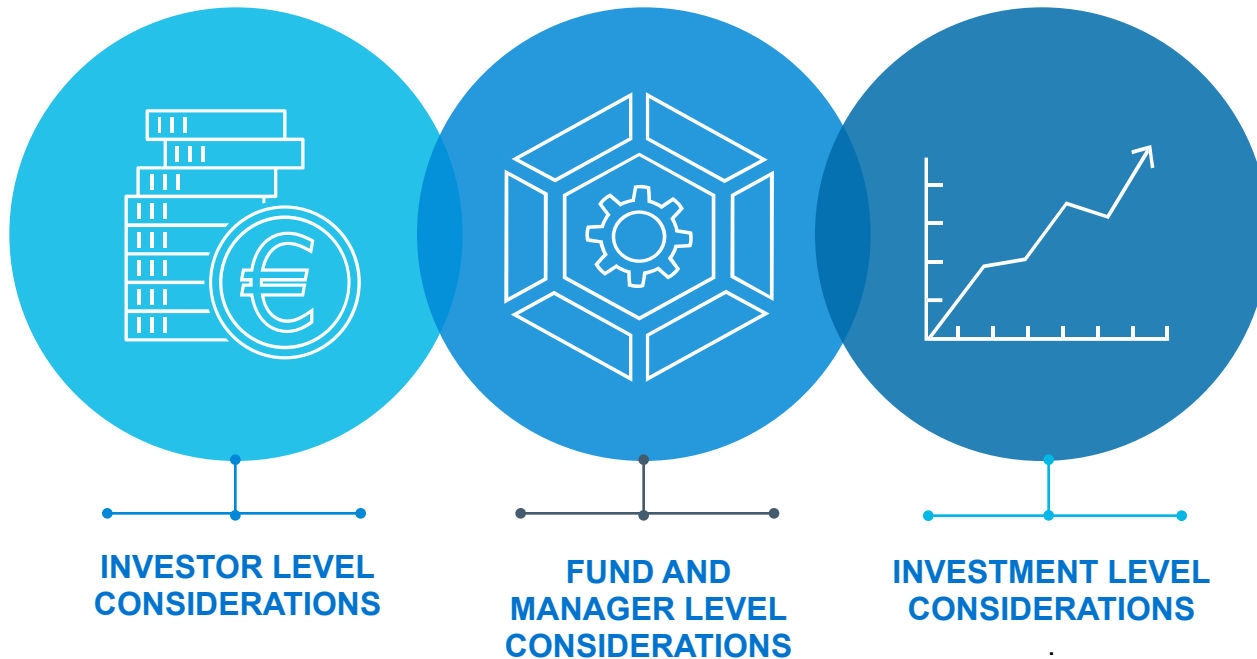
Refund of the WT to the fund

- › **There may be situations where the refund is limited in proportion to the payments made to residents of State C**
 - → the fund is treated in a discriminatory way because some investors are non-residents
 - → compare with former Dutch law which was considered inconsistent with EU law (ECJ, 20 May 2008, Orange European Smallcap Fund NV, C-194/06)
- › **Could the fund argue that such discriminatory infringes Art. 24?**
 - Art. 24.5 : Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first mentioned State are or may be subjected.
 - Applicable also in the case where investors in State C are minority ?
 - What about art. 24.3 if the fund is treated as PE?

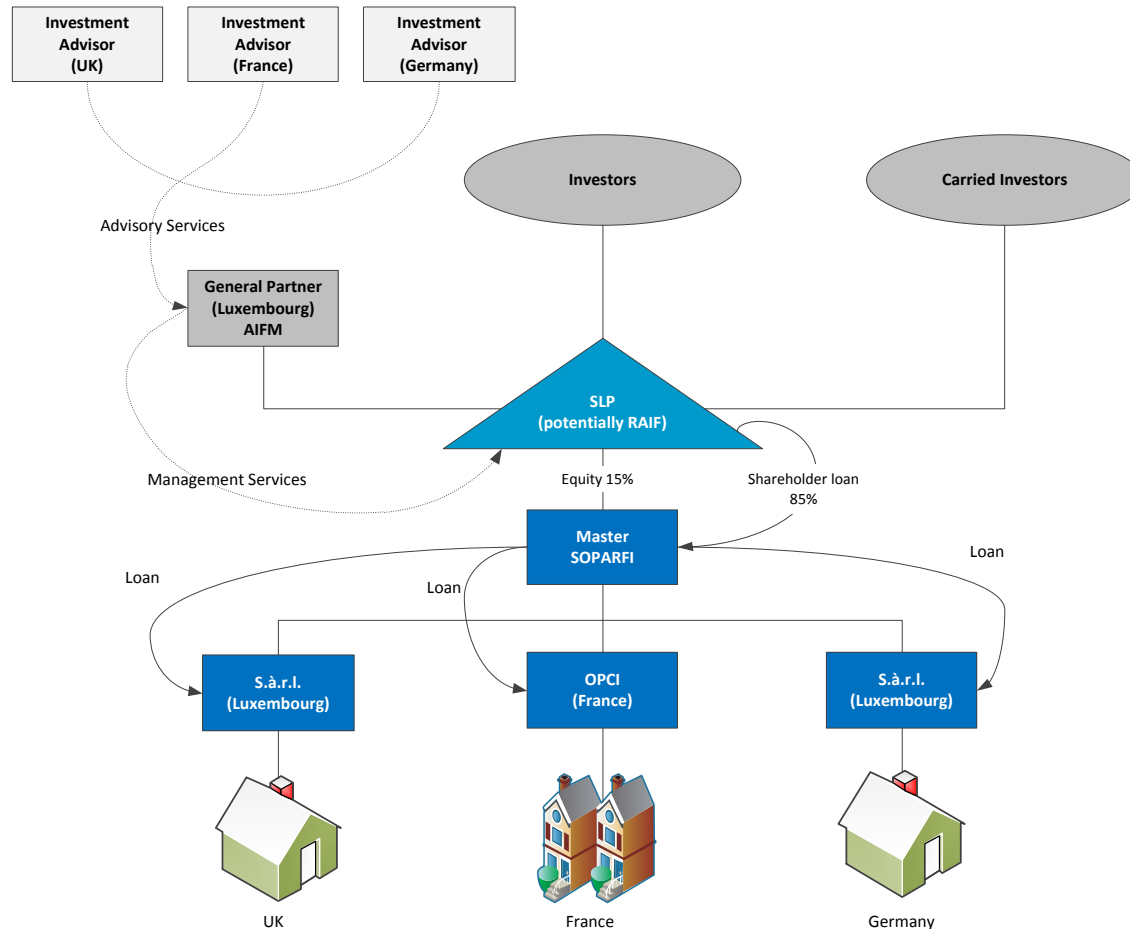


THANK YOU FOR YOUR ATTENTION

Fund structuring: key considerations

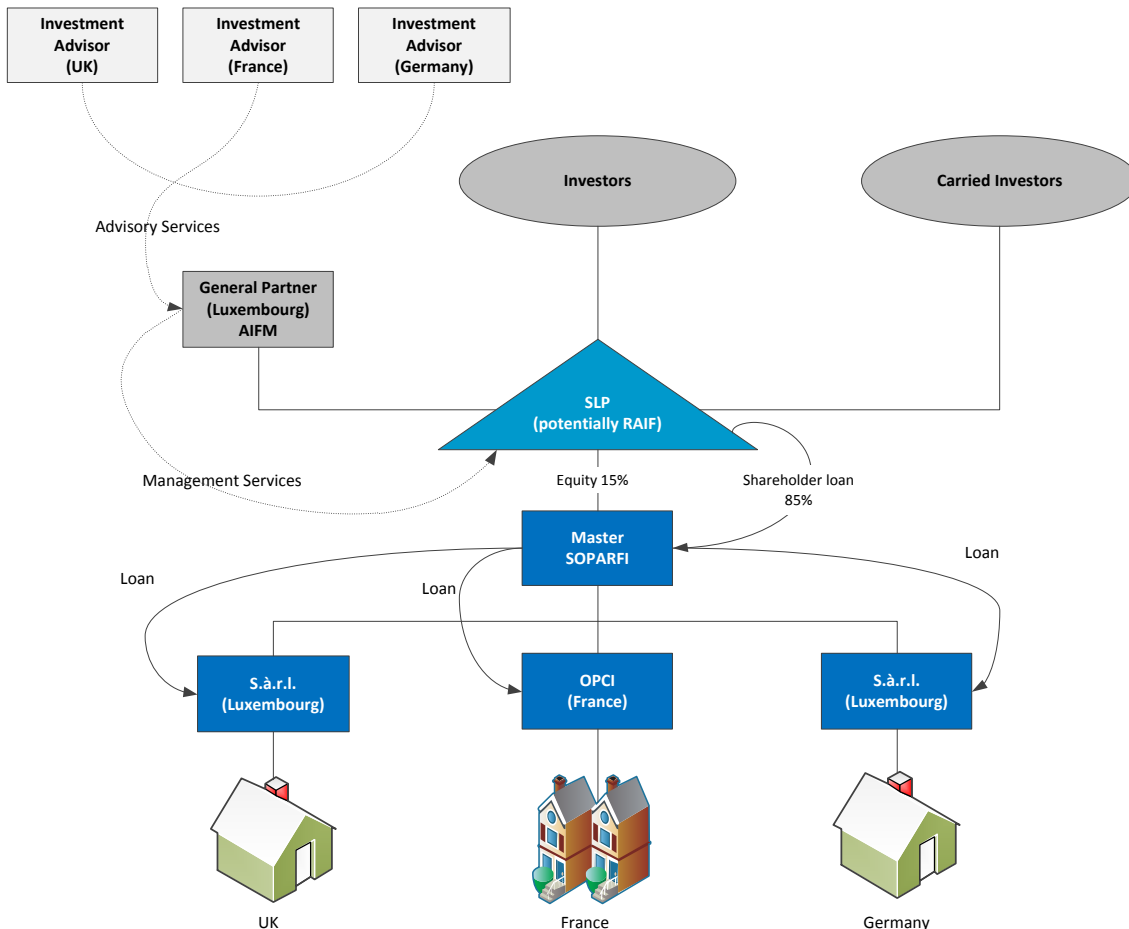


Basic structure highlights for real estate platform



- The Fund - tax transparent vs opaque, normally taxable entity or benefitting from a specific tax regime
- Assuming non taxed fund vehicle (RAIF, limited partnership etc.), a normally taxable LuxCo (Master SOPARFI) may be required to benefit from treaty protection
- Mix debt-equity for the financing (leveraging the PropCos)
- Advisors on the ground
- Lux AIFM (preferred alternative)
- For Investors, need of feeder(s)?
- Carry vehicle?
- For the investments case-by-case analysis:
 - in UK - Luxembourg private limited liability company (S.à r.l.)
 - in France - OPCI (tax exempt RE fund)
 - in Germany - Luxembourg private limited liability company (S.à r.l.)

Domestic considerations



Taxable fund / interposed Soparfi

■ Repatriation structure

- Entity will be funded with a mix of equity (divided into classes of shares) and debt bearing an arm's length interest rate
- Debt to equity ratio 85:15
- No aggressive repatriation schemes

■ Master SOPARFI - application of participation exemption/allocation of taxing right to another state under the treaty/ exemption under the treaty (specific for OPCI)

■ Arm's length margin on Master SOPARFI intra-group financing activity should be taxable

■ Arm's length remuneration of the GP/ ManCo – will significantly differ depending on the regulatory set-up

■ VAT treatment of management and advisory services – deduction of input VAT?

■ Recharge to interposed holding, deduction right under Larentia – Minerva?

International considerations



Asset side:

■ Germany:

- German corporate income tax at 15.8%
- No withholding tax on withdrawals from the Sarl
- As from 2017: no capital gain tax upon sale of the Sarl (tax discount)

■ UK: no tax on capital gains, 20% on rental income before leverage

■ France: 5% withholding tax in France on dividend distributions by the OPCI to S.à r.l. (under the Lux France double tax treaty)

■ Requirements from a foreign tax standpoint:

- Material substance
- Beneficial ownership
- Main purpose test

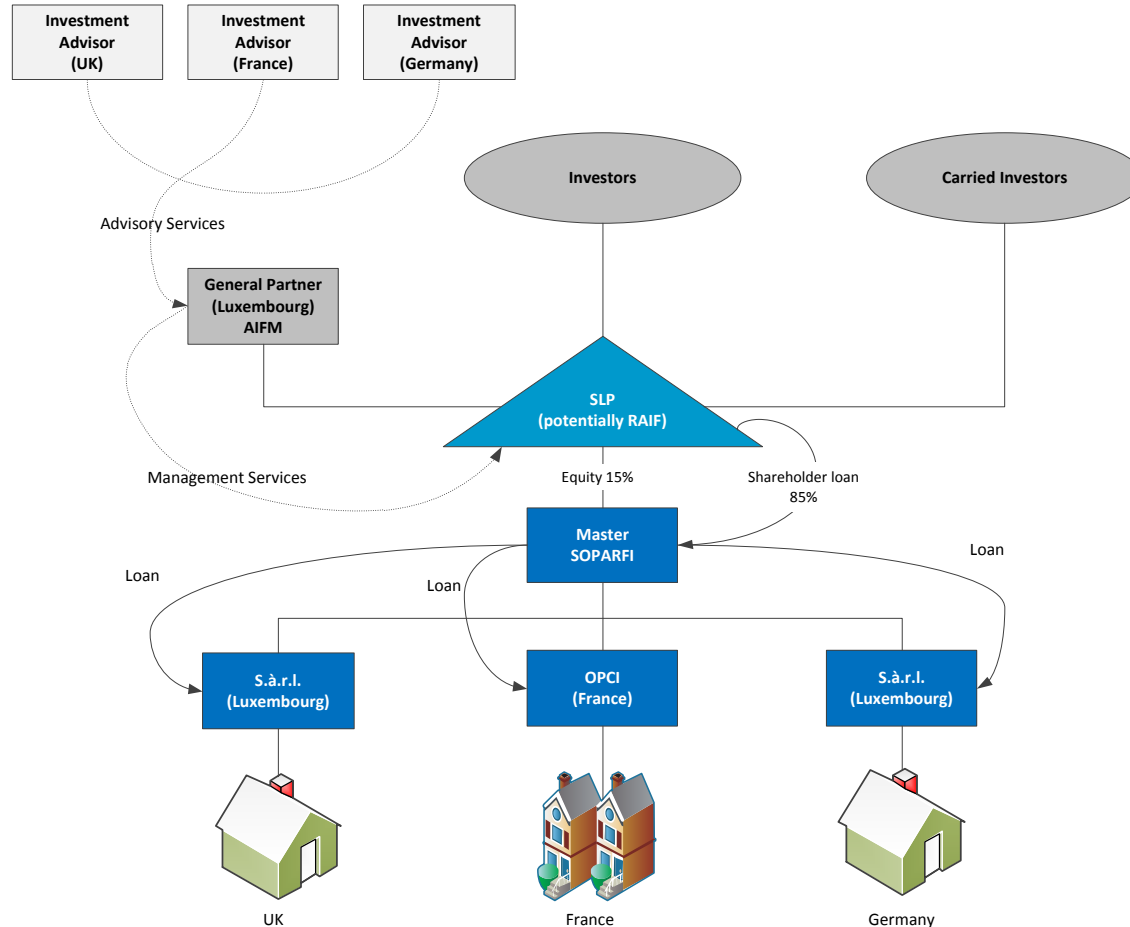
■ Difficulties when foreign AIFM

■ Deductibility of interest / hybrid mismatches

Investors side

■ Carried investors – specific regime to achieve?

■ Regular investors – capital gains vs income



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