



# Investment funds



# I. Introduction

Your team for today:

- Olympe Alexandre (session secretary)
- Delphine Charles-Péronne
- Roland Hummel
- Sung H. Hwang (general reporter)
- Nigel Johnston
- Floran Ponce
- Jean Schaffner (session chair)
- Oktavia M. Weidmann (general reporter)

# 1.1 Today's presentation



- Introduction to funds
- Presentation of General report
- Taxation of funds
- Taxation of investors
- Treaty access
- Taxation of managers

## 1.2 What is an investment fund?



### **Vehicle for collective investment:**

- Multiple investors and pooling assets
- Several investments, achieving some form of risk diversification
- Professional management to maximise return
- Level playing field with HNWI

## 1.2 What is an investment fund?



### Various investment strategies:

- Retail, securities
- Real estate, infrastructure
- Venture capital (**VC**)
- Private equity (**PE**)
- Hedge funds
- Debt/Distressed debt
- More exotic: cars, wine, cryptocurrencies, etc.

## 1.2 What is an investment fund?



### Various categories:

- Regulated, unregulated, manager regulation
- Company, partnership, contractual, trust
- Open or closed-end
- Accumulation or distribution
- Listed or unlisted
- Limited or unlimited duration

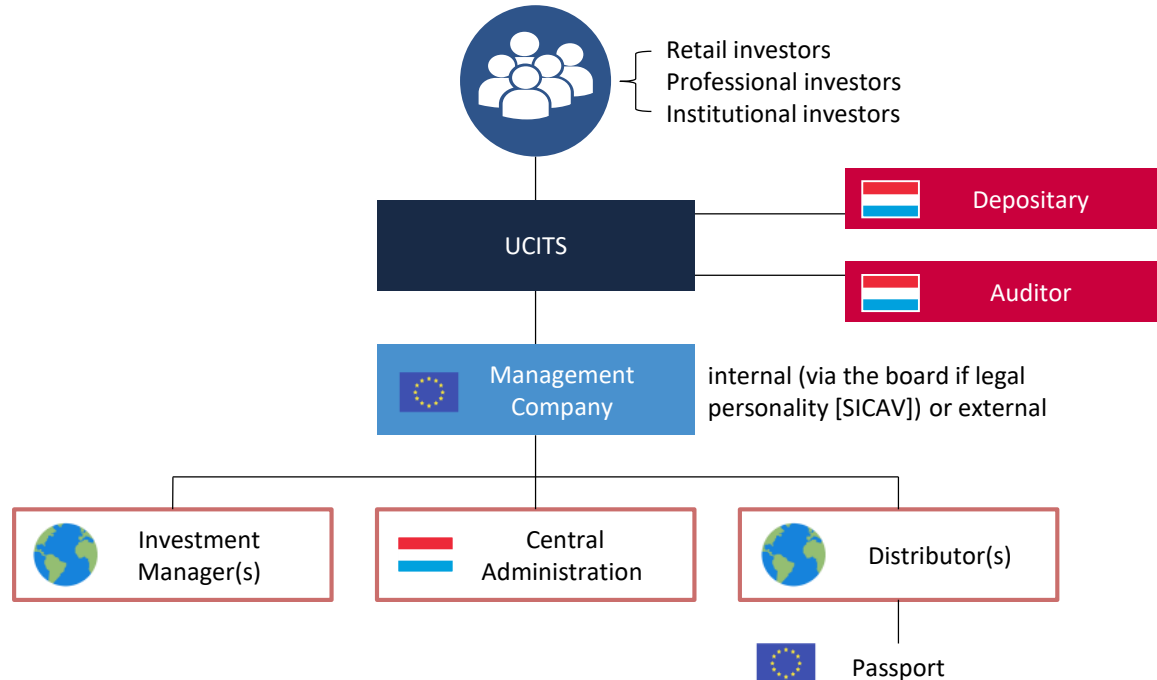
# 1.3 The different fund constellations



- Public/Retail Funds (UCITS, mutual funds, exchange traded funds (**ETFs**))
  - Open to investment by public
  - Strict regulation of ownership schemes and assets
- Private Funds
  - Open only to sophisticated investors with resources
  - More fluid rules on ownership schemes and assets
  - PE/VC Funds: focus on non-publicly available securities
  - Hedge Funds: traditional focus on publicly traded securities and related derivatives
- Real Estate Funds (including REITs)
  - May be public or private, but with real estate focus

# 1.3 The different fund constellations

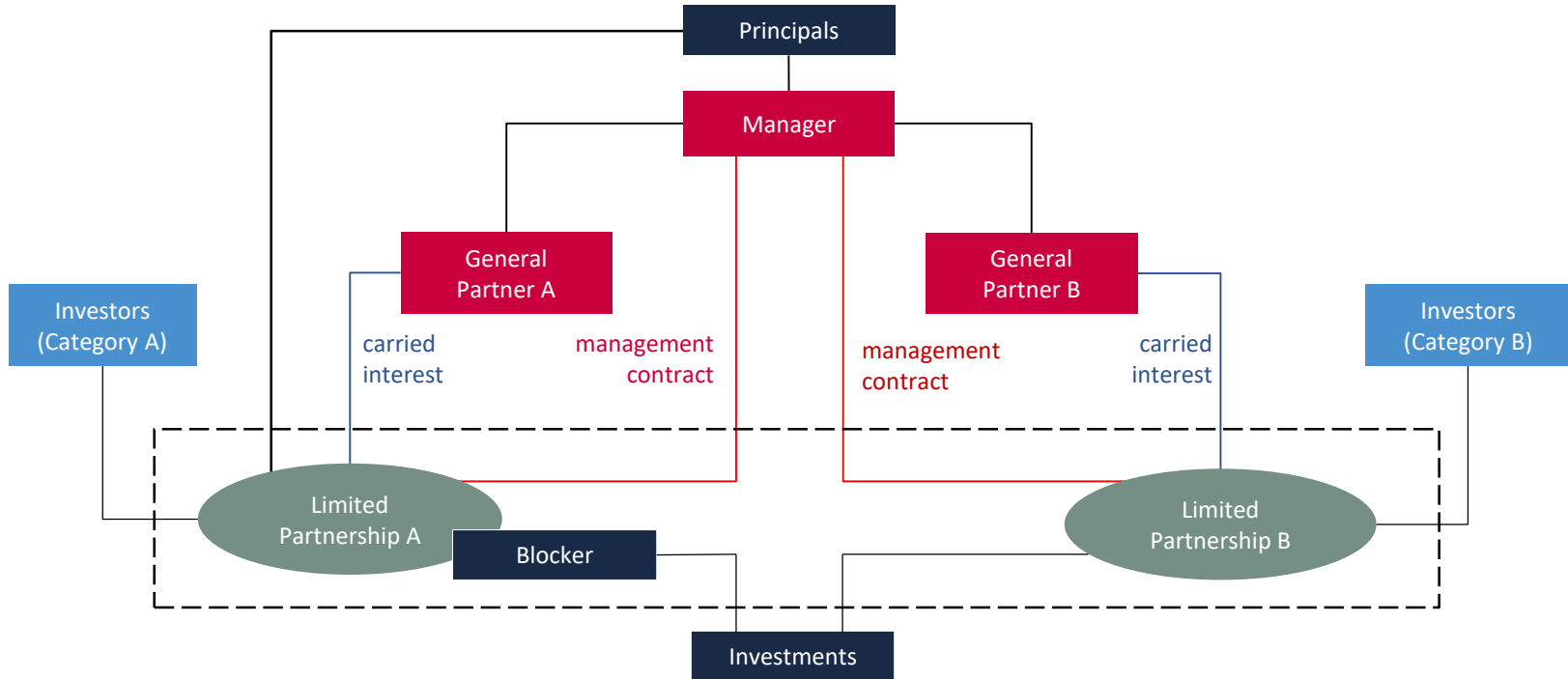
## Retail fund: example of a Luxembourg UCITS (SICAV)





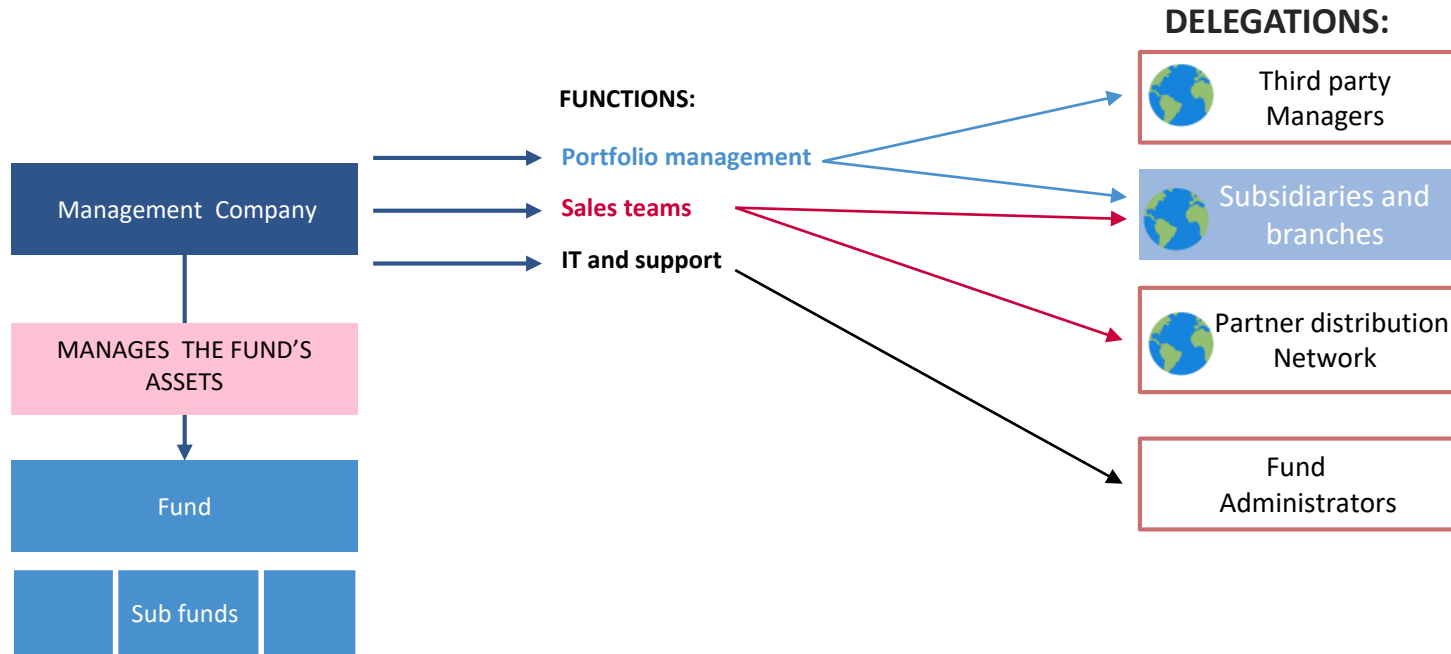
# 1.3 The different fund constellations

## Private equity fund – simplified typical structure



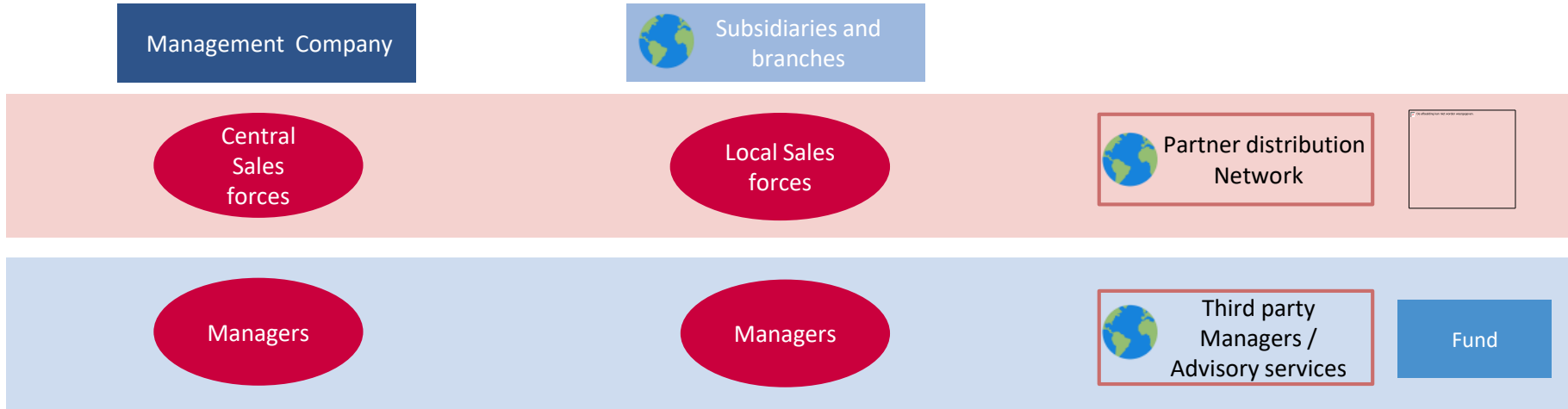
# 1.3 The different fund constellations

## The players (1 – Functions)



# 1.3 The different fund constellations

## The players (1 – Functions)



The Fund's management may be broken down between a number of separate services (VAT and transfer pricing consequences)

# 1.3 The different funds constellations

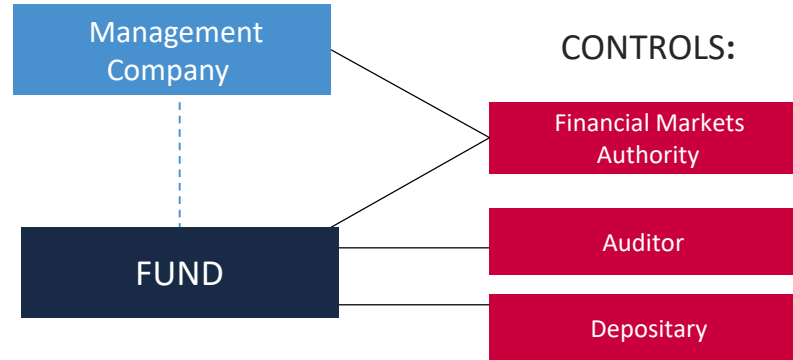
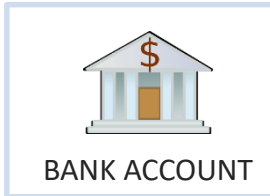
## The players (2 – Liabilities and controls)



### FUND'S INVESTORS ACCOUNTS:



OR



## II. Presentation of General report

- Oktavia M. Weidmann
- Sung H. Hwang



## 2.1 Investment funds – the landscape



- Assets under Management (**AuM**) worldwide have almost tripled from US\$27 trillion (US\$ 27'000 billion) in 2002 to more than US\$ 79 trillion (US\$ 79'000 billion) in 2017
- The increase in AuM worldwide has:
  - Broadened investor base both at the level of retail investors and institutional investors
  - Increased inflows for both passively and actively managed retail and institutional investor funds
- Retail AuM amounted to approximately 39% of the total AuM in 2017
- “Alternative AuM” amounted to more than 15% of the total AuM

## 2.2 Investment funds – the trends



- New types of funds have emerged in the past 20 years

Examples: funds focusing on:

- Environmental credits, carbon tax, socially responsible investments (**SRI**), cannabis
  - Digital assets (including those issuing crypto-currency instead of traditional equity interests in such funds)
- In certain areas, the traditional economic arrangements have been altered as a result of the new investment purposes:

Examples:

- Investment objectives restricting profitability of SRI funds
- Legal constraints on cannabis funds

## 2.3 General report – the objectives



- Survey of the current state of taxation of investment funds around the world
- Examination of assumptions and challenges associated with prevailing policies and theories that have driven:
  - The evolution of the domestic and international taxation of investment funds
  - Their investors, and
  - Their managers



## 2.4 General report – the topics



- Part One: Analysis of the **taxation of investment funds**, including mutual funds/UCITS, hedge funds/AIFs, PE funds and real estate funds/REITS
- Part Two: Analysis of the **taxation of fund investors**; those investing into domestic and foreign funds and non-resident investors
- Part Three: Outline of the **taxation of investment managers** in respect of management fees, performance fees and incentive allocations

## 2.5 Investment fund grouping



### Mainstream funds:

- Available to retail investors, widely-held, heavily regulated, sometimes eligible for tax preference
  - Non-traded funds focusing on portfolio securities  
e.g., open-ended mutual funds, UCITS
  - Publicly traded funds focusing on asset/sector-specific funds  
e.g., exchange traded funds, US publicly traded partnerships

## 2.5 Investment fund grouping



### Private funds:

- For sophisticated investors only, less regulated, able to take on riskier or sector-specific investment strategies, structured to qualify for generally available tax benefits
  - **Hedge funds** – focused on publicly traded securities
  - **PE funds** – focused on limited range of securities invested, with participation in the management of invested companies and/or active structuring of the investments, when compared to a portfolio investment

### Real estate funds:

- Funds modelled on PE funds
- REITs

## 2.6 General report – the findings (1)



- The **taxation of investment funds** is rapidly evolving and is not uniform across the different countries
- **Regulatory rules** are having greater impact on taxation of investment funds, especially those qualifying for preferential tax regimes (US regulated investment companies (**RICs**); qualifying REITs)

## 2.6 General report – the findings (2)



- Survey of the 42 branch reports:
  - The taxation of mainstream funds, such as mutual funds and UCITS, appears to have **tax neutrality** as the key tax policy consideration in the various countries
  - Lack of consensus on definition of tax neutrality, however
  - Taxation of real estate funds (including REITs) has the opposite objective (preferential tax treatment of domestic real estate funds)

## 2.6 General report – the findings (3)



- Tax neutrality is often not implemented in a systematic and co-ordinated manner
- Many countries strive for “**vertical**” as well as “**horizontal**” tax neutrality in relation to the taxation of resident and non-resident investors in domestic mainstream investment funds:
  - **vertical**: avoidance of economic double taxation
  - **horizontal**: fund treated for tax purposes similarly to a direct investment
- But these goals are often not achieved, or desired based on tax-policy considerations in respect of:
  - resident investors investing in either foreign mutual funds, or domestic and/or foreign hedge funds, in particular those resident in low tax jurisdictions;
  - similar for investment funds focused on real estate (e.g., REITs)

## 2.6 General report – the findings (4)



- **Uniformity** in approaches in applying **domestic tax benefits and DTT benefits** has gained momentum and should continue to be the key priority for policymakers, in particular, with regard to multi-jurisdictional constellations
- **Tax residency** of investment funds may have different connotations from the tax residency of a normal company or holding company
  - Countries sometimes have fewer **substance requirements** for accepting tax residency of a fund in the particular country compared to holding companies or conduits
- **Tax treaty access** of investment funds which are taxed as companies, and in principle are entitled to tax treaty benefits, may be solved appropriately in the context of **LOB clauses** to limit DTT access via investment funds for non-treaty investors

## 2.6 General report – the findings (5)



- Tax authorities in some countries do not abstain from regarding either a domestic investment manager or a domestic fund advisory entity as a permanent establishment of an offshore investment fund or an offshore investment management company
- Some countries have however implemented legislation which explicitly states that the domestic investment manager is not a permanent establishment of the offshore fund
- Other countries have implemented safe harbor rules for investment managers not to qualify as permanent establishment of the investment fund



## 2.6 General report – the findings (6)



- The vast majority of investment funds in **low-tax jurisdictions** that act as investment **conduits** to other jurisdictions are set up for genuine investment reasons
- The fact that a fund has been set up in such a jurisdiction alone **does not indicate** that **tax avoidance** is the key reason for the choice of jurisdiction e.g., Cayman Islands funds
- But only that the fund seeks **tax neutrality** or **sometimes preferential tax treatment** within **generally acceptable** legal and tax boundaries

# III. Taxation of funds and investors



# 3.1 Various types of taxation of the fund

## Tax neutrality



- **Policy objective of tax neutrality** (same business same rules)
  - Avoidance of double taxation or multiple levels of taxation
  - Taxation of investors equivalent to a direct ownership in the underlying assets
- Most countries follow this policy objective in the design of their domestic tax regime for funds (exception for real estate funds which often follow a different regime)
- Need to balance with **policy objective of compliance and practical administration**

## 3.1 Various types of taxation of the fund

### Types of income taxation of investment funds

- **Tax transparent** (taxation of investors)
- **Fund taxation** (taxation of the fund)
- Deduction for distributions to investors (taxation of the fund or of the investors)
- Mixed regimes
  - Depending on the legal form of the fund
  - Depending on the nature of the income

# 3.1 Various types of taxation of the fund

## Types of income taxation of investment funds



- **Tax transparent (taxation of investors)**
  - Pure pass-through
    - Daily allocation of income to investors
    - Best for tax neutrality
    - Uncommon and only possible for private funds
  - **Modified pass-through:**
    - Aggregation of all different types of income at the fund level
    - Reporting by the fund to investors in categories on a periodical basis
    - Need to tax accumulation funds like distribution funds
  - Tax on distributions only (**deferral**)

# 3.1 Various types of taxation of the fund

## Types of income taxation of investment funds



- **Fund taxation** (taxation of the fund)
  - **Reduced taxation** or some form of exemption
  - Specific rate to reflect the rate of investors
  - Only workable in countries with secular taxation of investment income
- **Deduction for distributions** to investors (taxation of the fund or of the investors)
  - Funds generally required to make distributions
  - Investors taxed on distributions
  - Allows to take into account specificities of investors

# 3.1 Various types of taxation of the fund

## Examples and group discussion re. income taxation



- **Switzerland:** tax transparency
- **France:** tax transparency or tax exemption (with the exception of debt funds structured as companies)
- **Luxembourg:** tax transparency or tax opacity depending on the legal form of the fund
- **Germany:** retail opaque (CIT), special funds with optional transparency for certain classes of income
- **Canada:** depends on the legal form

# 3.1 Various types of taxation of the fund

## Other taxes paid by investment funds (withholding tax)



- **Withholding taxes (WHT)** on fund distributions:
  - No WHT
  - WHT on all distributions to investors
  - WHT on certain distributions to investors
    - Depending on the **type** of income (dividends vs. capital gains)
    - Depending on the **source** of income (domestic vs. foreign)
    - Depending on the **residence** of the investors
- Subscription taxes (e.g., Luxembourg)



# 3.1 Various types of taxation of the fund

## Examples and group discussion: withholding tax



- **Luxembourg:** no WHT
- **Switzerland:** 35% withholding tax on distributions or deemed distributions of dividends and interest
- **Germany:** WHT on German source dividends
- **Canada:** 25% WHT on income distributions and ordinary dividends to non-residents; 25% WHT on distributions of capital gains to non-residents unless payor is a “mutual fund trust” or “mutual fund corporation”
- **France:** see next slide

# 3.1 Various types of taxation of the fund

## Examples and group discussion: withholding tax



- **France:** WHT on French source dividends to non-residents (except when paid to “similar” foreign funds: no WHT)
- EU law guarantees certain **fundamental freedoms** and prohibits discrimination between EU taxpayers depending on residency; **free movement of capital** applies as well to non-EU investors:
  - ECJ, **Aberdeen** (C-303/07): dividends paid by a company from one country (Finland) may not be subject to a higher taxation if paid to a fund in another country (Luxembourg) than if paid to a domestic fund
  - **Emerging Markets** (C-190/12): confirmed on Polish source dividends distributed to US fund
- Key issue: comparison between domestic and foreign funds is necessary; when are these funds comparable?

## 3.2 Taxation of the investors



Tax aspects relevant to investors comprise:

- Liability to tax on income of/from investment fund:
  - Tax basis: items of income:
    - **opacity vs. transparency**
    - distributions
    - gains/losses on disposal
    - others, e.g. advance lump sum amount
    - special tax regimes (incl. CFC, PFIC legislation)
  - **Tax exemptions** (domestic, treaty)
  - Tax rate
  - **Timing**

## 3.2 Taxation of the investors



Tax aspects relevant to investors comprise:

- **Tax compliance:**
  - Withholding taxes
  - Refund claims
  - Domestic and foreign reporting and filing requirements (availability of data, administrative efforts)
- **Financial reporting:**
  - Tax effects on fund or investor level

## 3.2 Taxation of the investors



Qualification of items of income may depend on:

- **Structure** of investment fund: partnership, corporation, trust, contract
- **Entity qualification** rules in domestic or cross-border context
- **Domicile/residency** of investor and/or investment fund
- **Special investment fund** qualification and **income** definition rules  
e.g., un-/regulated funds (UCITS, AIF, REITs), pension funds
- **Elections** (opt-in or out of tax transparency)

## 3.2 Taxation of the investors



Qualification of items of income may depend on:

- Investment held as **trading/business** asset or as **private** investment
- **Quantum** of investment
- **Low taxation** of investment fund/application of **CFC/PFIC** legislation
- **Tax treaty** qualification

## 3.2 Taxation of the investors



- Tax neutrality:
  - investment in fund is only **taxed once** and **equal** tax treatment of alternative direct investment into target assets and those via an investment fund
  - general consensus among the countries, that tax neutrality is desirable
  - targets pursued by tax jurisdictions to varying degrees
- But **concerns over drain of revenue** in case of foreign investors, EU-boundaries; income reclassification, abusive structures (low tax jurisdictions)

# IV. International aspects





# 4.1 Why not set up a fund in a tax haven?



- **No tax** imposed by tax haven on the fund (income tax and WHT)
- **No treaty** access:
  - No reduced WHT on distributions to fund
  - Taxation of capital gains
- Use of **intermediate vehicles**:
  - Holding companies
    - Substance and beneficial ownership issues: ECJ Danish case law; OECD developments on non-CIVs (Commentary on Article 29 OECD Model Tax Convention (**OECD MC**))
    - WHT on cash repatriation; use of debt leverage and of various repatriation techniques

## 4.2 Treaty access

### Conditions for treaty access

- **Impractical** for investors in funds to have to claim benefits in own right
- If fund not entitled to relief, **neutrality** in international context not achieved
- Pre-2010, few tax treaties specifically contemplated funds
- Normal **conditions** apply to fund to claim relief:
  - Fund is a “person”
  - Fund is a “resident” of a Contracting State
  - In the case of interest, dividends and royalties, fund is “beneficial owner”
  - LOB in some cases

## 4.2 Treaty access “Person”



- Have to be a “**person**”:
  - **Corporation** is a person
  - **Co-ownership arrangement** is not a person (Luxembourg FCP), but may be treated as a corporation (Spanish FCR)
  - **Partnership** may be a “person”
  - **Trust** may be expressly included

## 4.2 Treaty access

### “Resident of a Contracting State”

- Have to be “**liable to tax**” in Contracting State by reason of domicile, residence, place of management, place of incorporation or similar criterion
  - If funds fiscally **transparent**, not liable to tax
  - Funds **exempt** from tax on some or all of their income
    - Some regard as liable to tax, others do not
  - Funds **not subject to tax** because of deductions for distributions, etc.
  - Funds subject to tax but at a **special low rate**

## 4.2 Treaty access “Beneficial owner”



- What is a **beneficial owner**?
  - More than mere nominee/fiduciary/administrator with limited powers?
  - Fund manager has discretionary powers to manage fund’s assets and vary investments; investors not entitled to influence management
  - What if required to distribute all of its income?

## 4.2 Treaty access

### Practical Issues



- **Source country** concerns:
  - Treaty shopping
  - Deferral
  - Even if all investors are domestic, fund may be able to access lower WHT rate than individual investors
- **Fund** concerns:
  - Clarity as foreign taxes affect calculation of NAV
  - Countries require funds to establish that investors are entitled to treaty relief (especially reclaims)

## 4.2 Treaty access

### ICG Report on CIVs



- **OECD Committee** on Fiscal Affairs established “ICG” in 2006
  - Extent to which “CIVs” or their investors are entitled to treaty benefits
  - Best practices for making and granting claims for treaty benefits in intermediated structures
- **ICG’s report** on CIVs adopted by Committee in 2010; amendments made to Commentary to the OECD Model Convention

## 4.2 Treaty access

### ICG Report on CIVs



- Definition of “**CIV**”:
  - Widely held
  - Diversified portfolio of securities
  - Subject to investor-protection regulation in country in which established
- Includes **master/feeder structure** where master holds diversified portfolio of securities and feeders are widely held
- Does **not include** REITs, PE funds, hedge funds



## 4.2 Treaty access

### ICG Report on CIVs



- **Policy issues raised**
- Economically similar CIVs could be treated differently due to legal form; could be appropriate when investor level taxation taken into account
- Treaty shopping/treatment of “equivalent beneficiaries”
  - Full treaty benefits
  - Proportionate claims
  - Publicly traded
- Deferral
- Loss of preferential benefits (e.g., pension plans)

## 4.2 Treaty access

### Changes to the Commentary to the OECD Model Convention



- Treaty negotiators should expressly address CIVs
- Define what a “CIV” is in each Contracting State
- Basic Provision:
  - CIV established in Contracting State treated as:
    - **Resident** of that Contracting State
    - An **individual**
    - **Beneficial owner** of income received (caveat, as long as resident individual receiving income in same circumstances would be beneficial owner)
  - Under basic provision, CIV gets full benefits of treaty

## 4.2 Treaty access

### Changes to the Commentary to the OECD Model Convention



- Variations to Basic Provision:  
**“but only to the extent that beneficial interests are owned by equivalent beneficiaries/residents of the residence state”**
  - CIV claims benefits on a proportionate basis
  - Threshold which entitles CIV to 100% benefits?
  - CIV whose securities are listed and regularly traded in the residence state is entitled to 100% benefits?

## 4.2 Treaty access

### Changes to the Commentary to the OECD Model Convention



- **“Conduit or Look-Through Treatment”**
  - CIV not treated as resident of Contracting State in which it is established
  - but may claim, on behalf of investors, the benefits they could have claimed if they received the relevant income

## 4.2 Treaty access

### Changes to the Commentary to the OECD Model Convention



- Necessity of establishing **ownership of interests**
  - Ownership changes daily
  - Intermediation: fund managers may not deal directly with investors/don't know their identities or treaty status
  - Need to adopt pragmatic rules
    - is a country's fund industry domestic?
    - is fund generally available only in treaty countries?

## 4.3 Treaty access, practical examples

### 2012 Germany/Luxembourg DTT



- **Investment funds** constituted in one contracting state
  - Germany: regulated pool of assets as per investment law
  - Luxembourg: undertaking for collective investment (*fonds commun de placement*)
- Deriving dividend or interest income from the other contracting state
- May claim treaty benefits (WHT reduction/exemption) under Art. 10 and 11 DTT
  - exclusive to investment fund, no claim by the unit holders
- To the extent the units in the investment fund are held by residents of the first-mentioned state (no equivalent beneficiaries)

## 4.3 Treaty access, practical examples

### 2011 Germany/Ireland DTT



- **UCITS** established in a Contracting State ... treated ... as resident of that Contracting State and the beneficial owner of the income it receives, to the extent (95% rule) that the beneficial interests in the UCITS are owned by **equivalent beneficiaries**
- **Common Contractual Fund established in Ireland** not regarded as a resident of Ireland and shall be treated as **fiscally transparent** for the purposes of granting tax treaty benefits

## 4.3 Treaty access, practical examples

### 2018 France/Luxembourg DTT



- New treaty (March 2018 – application 01.01.2020)
- Look-through treatment: the fund is not a resident
- **“Equivalent beneficiary” type of test**
- Difficult to apply to funds with bearer shares



## 4.4 BEPS Action 6/PPT



- Final Report states general support for conclusion in the OECD 2010 report relating to CIVs (as defined)
- Provision in proposed LOB rule for CIVs reflects those conclusions
- No similar conclusion for non-CIV funds; further work required on policy considerations

## 4.4 BEPS Action 6/PPT Background



- Central part of “**minimum standard**” that countries must implement pursuant to the report on Action 6 (treaty shopping) of the OECD Plan on Base Erosion and Profit Shifting (**BEPS**) adopted in 2015
- Implemented through participating countries’ adoption of OECD MC (2017) for future treaties, and the Multilateral Instrument (**MLI**) for existing treaties

## 4.4 BEPS Action 6/PPT Language



“Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is **reasonable to conclude**, having regard to all relevant facts and circumstances, that **obtaining that benefit** was **one of the principal purposes** of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be **in accordance with the object and purpose of the relevant provisions** of this Convention.”

## 4.4 BEPS Action 6/PPT

### Example D – Comments Art. 29 OECD MC



#### Facts:

- Fund established in State R
- Majority of investors in State R
- Fund distributes income annually
- 15% of securities in State S

#### Conclusion:

Would not be reasonable to deny treaty benefits

## 4.5 How to solve the practical issues?



- Blockchain
- TRACE

## 4.5 How to solve the practical issues?

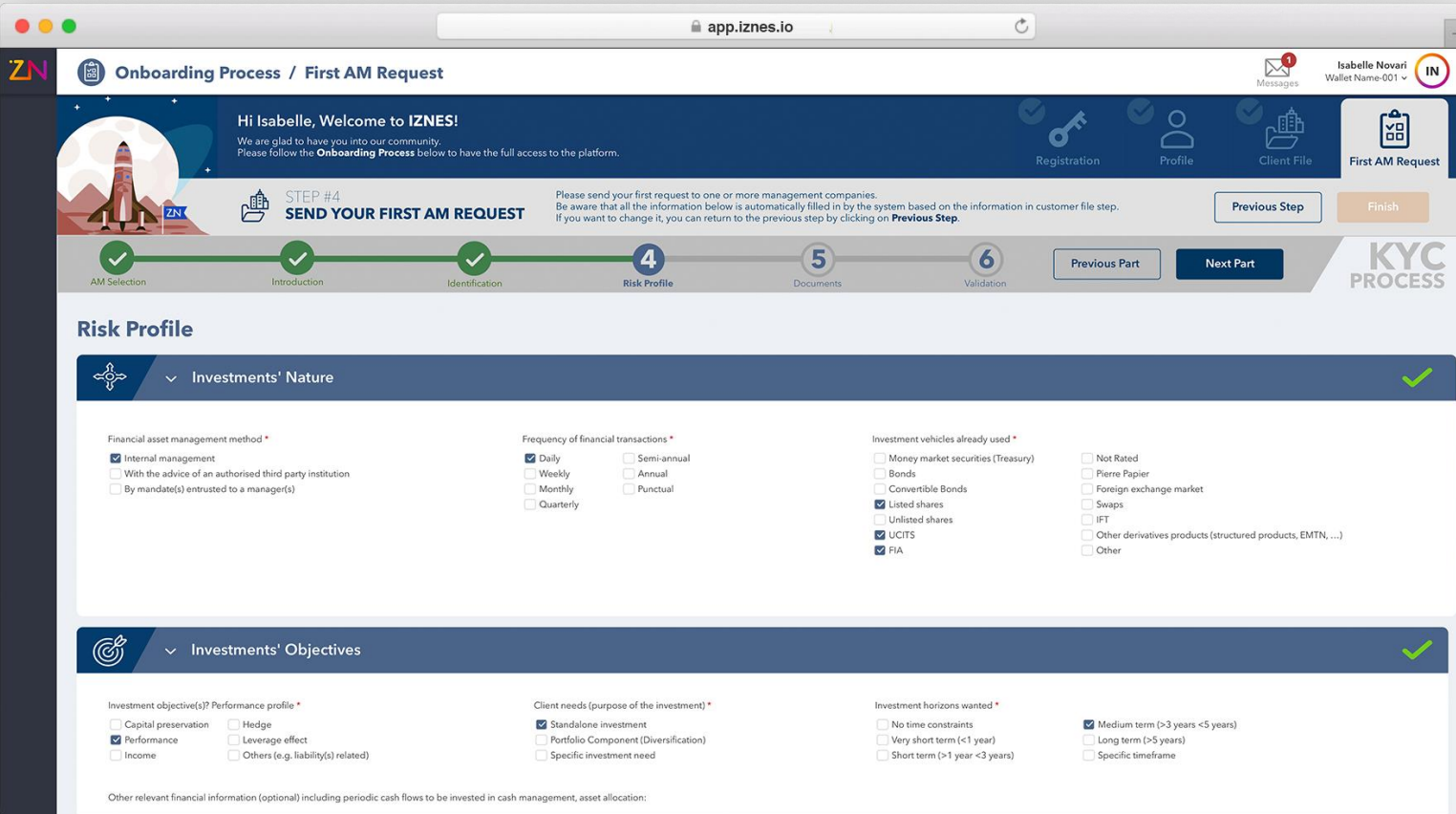
### Blockchain platforms



- New development: transactions recorded in real-time through platforms powered by blockchain technology
- The platforms enables investors to subscribe and redeem fund units via a direct connection with asset management companies
- Simple and secure management of client on-boarding: KYC, AML, MiFID
  - Tax reports automatically generated on the platform: the investor has to provide the system with his self declaration form
  - **The manager benefits from a permanent list of all the fund's investors with tax residencies**

# 4.5 How to solve the practical issues?

## Blockchain platforms



The screenshot shows a web browser window at `app.iznes.io` displaying the 'Onboarding Process / First AM Request' page. The user is Isabelle Novari, with a wallet name of 001. The interface includes a navigation bar with 'Registration', 'Profile', 'Client File', and 'First AM Request' options. A progress bar indicates the current step is 'STEP #4 SEND YOUR FIRST AM REQUEST', with previous steps 'AM Selection', 'Introduction', and 'Identification' completed. The 'Risk Profile' section is active, showing 'Investments' Nature' and 'Investments' Objectives' with various selection options.

**Onboarding Process / First AM Request**

Hi Isabelle, Welcome to IZNES!  
We are glad to have you into our community.  
Please follow the **Onboarding Process** below to have the full access to the platform.

Registration Profile Client File First AM Request

**STEP #4 SEND YOUR FIRST AM REQUEST**

Please send your first request to one or more management companies.  
Be aware that all the information below is automatically filled in by the system based on the information in customer file step.  
If you want to change it, you can return to the previous step by clicking on **Previous Step**.

AM Selection Introduction Identification **4 Risk Profile** 5 Documents 6 Validation

Previous Step Finish

Previous Part Next Part

KYC PROCESS

### Risk Profile

#### Investments' Nature

Financial asset management method \*

- Internal management
- With the advice of an authorised third party institution
- By mandate(s) entrusted to a manager(s)

Frequency of financial transactions \*

- Daily
- Weekly
- Monthly
- Quarterly
- Semi-annual
- Annual
- Punctual

Investment vehicles already used \*

- Money market securities (Treasury)
- Bonds
- Convertible Bonds
- Listed shares
- Unlisted shares
- UCITS
- FIA
- Not Rated
- Pierre Papier
- Foreign exchange market
- Swaps
- IFT
- Other derivatives products (structured products, EMTN, ...)
- Other

#### Investments' Objectives

Investment objective(s)? Performance profile \*

- Capital preservation
- Performance
- Income
- Hedge
- Leverage effect
- Others (e.g. liability(s) related)

Client needs (purpose of the investment) \*

- Standalone investment
- Portfolio Component (Diversification)
- Specific investment need

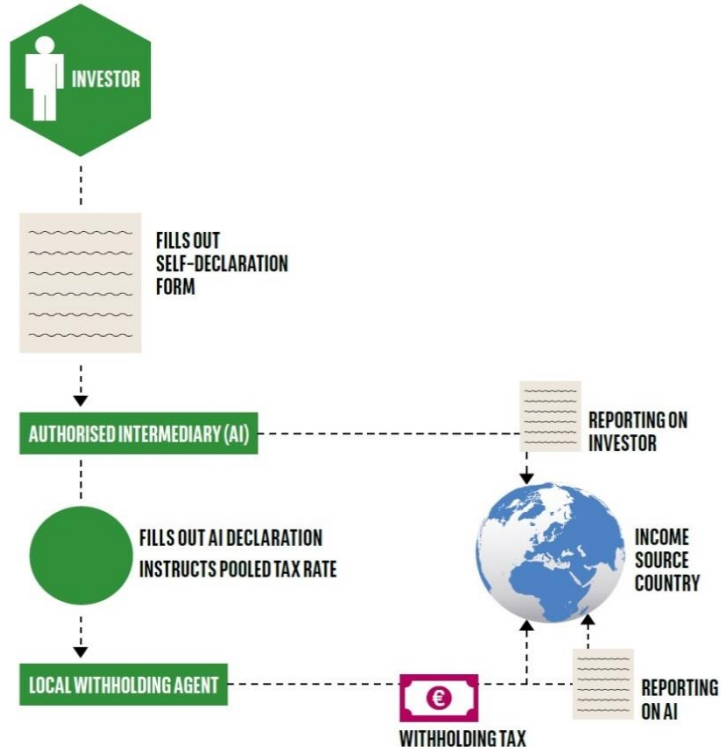
Investment horizons wanted \*

- No time constraints
- Very short term (<1 year)
- Short term (>1 year <3 years)
- Medium term (>3 years <5 years)
- Long term (>5 years)
- Specific timeframe

Other relevant financial information (optional) including periodic cash flows to be invested in cash management, asset allocation:

# 4.5 How to solve practical issues?

## TRACE (Treaty Relief and Compliance Enhancement)



- **OECD project** adopted in 2013 but not yet implemented
- **Simplified procedure** to tax documentation: replacement of certificates of tax residence through the use of an investor self-declaration form
- An **intermediary** is allowed to operate through pooled accounts and instruct the WHT agent what rates to apply (cf. QI regime)
- Subject to the signature of **agreements** with each income-source country and to external audits
- Finland will apply TRACE as of 2021 through a “Register of Authorised intermediaries”



## 4.6 FATCA/CRS



	FATCA	CRS
When	2014	2017 (EU directive: 2016 for early adopters)
Initiative	US	OECD/EU directive (90+ countries)
Registration/responsible officer/expanded affiliated group	Yes	No
Due diligences	All account holders via self certifications	
Reporting	US persons	All account holders
Thresholds and exemptions	Yes	Limited
Penalty	WHT 30% on US source payments	Local penalties

## 4.6 FATCA/CRS



### **Entities that are financial institutions:**

- Review their Financial Accounts (a fund's register is a financial account)
- To identify Reportable Accounts
- By applying due diligence rules
- Then report the relevant information

## 4.6 FATCA/CRS



### Application to the funds industry

In the case of funds whose units are held:

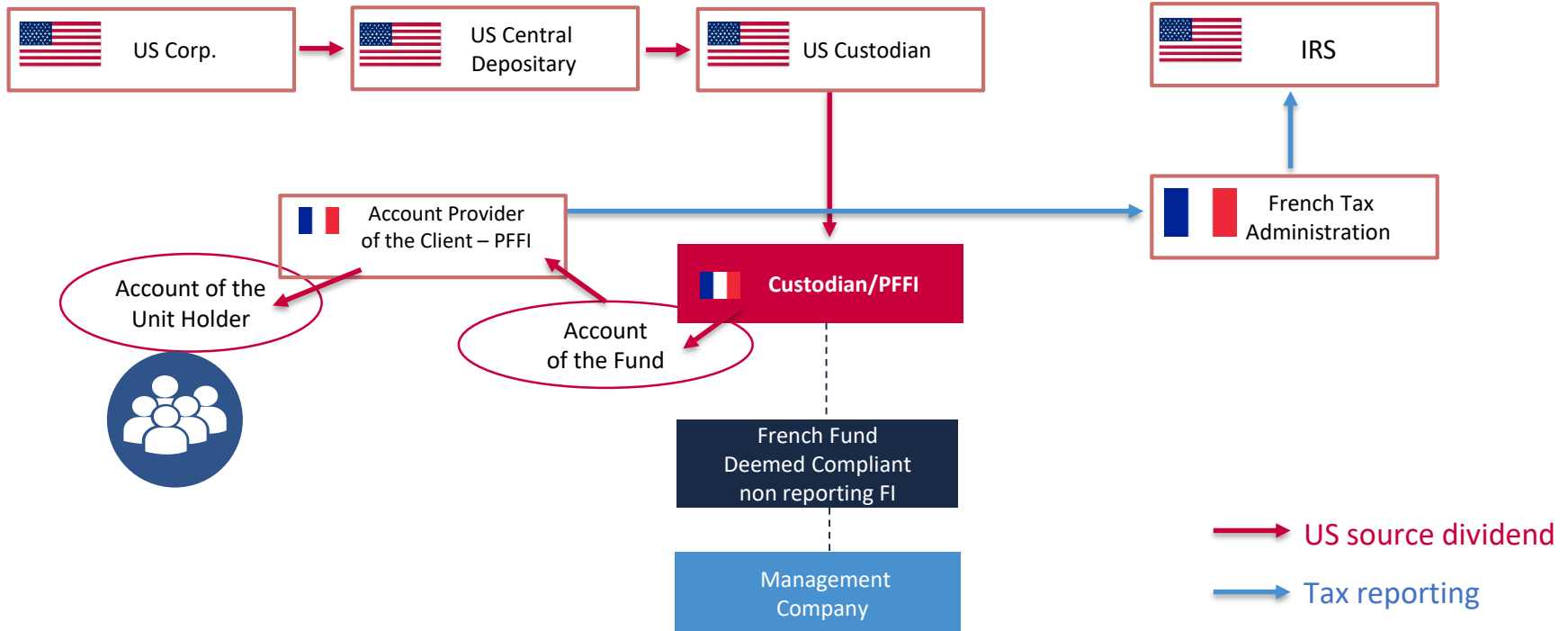
- Through a clearing system, or
- By a financial institution (custodial account of the investor)

the fund itself is considered as **“deemed compliant”** i.e., **without the need to identify (FATCA) nor report**

In practice the due diligence and reporting requirements will be carried out by the FI or authorized participants who trade units in the fund through the clearing system

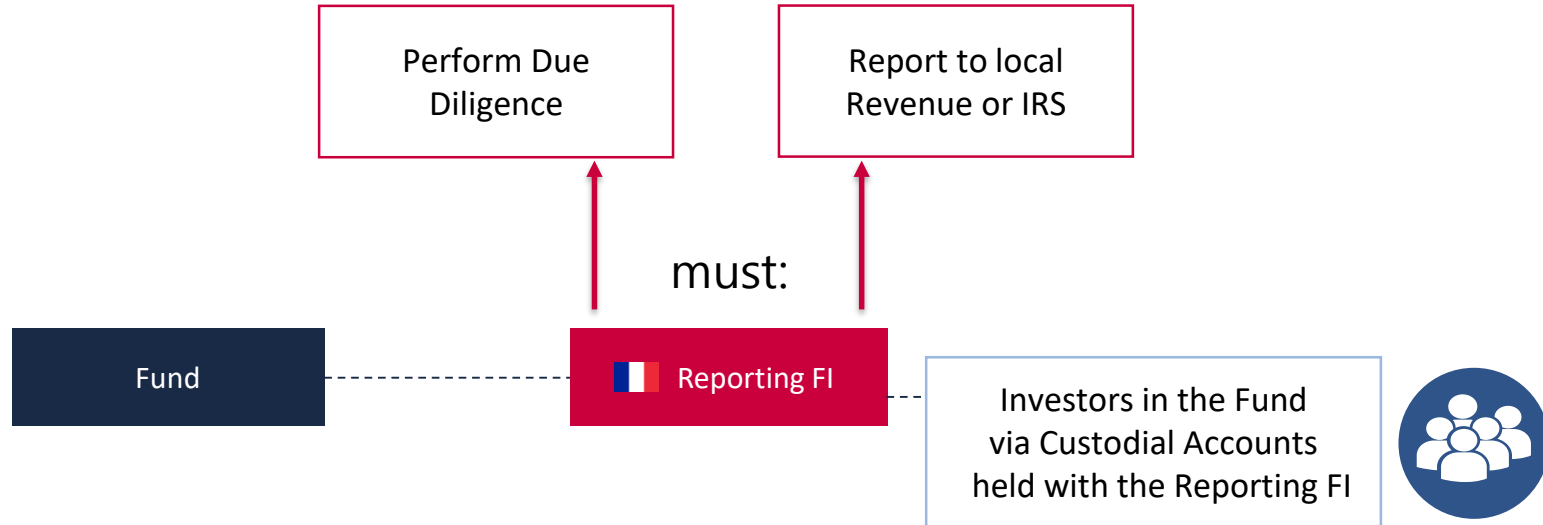
# 4.6 FATCA/CRS

## Fund securities held through an FI



## 4.6 FATCA/CRS

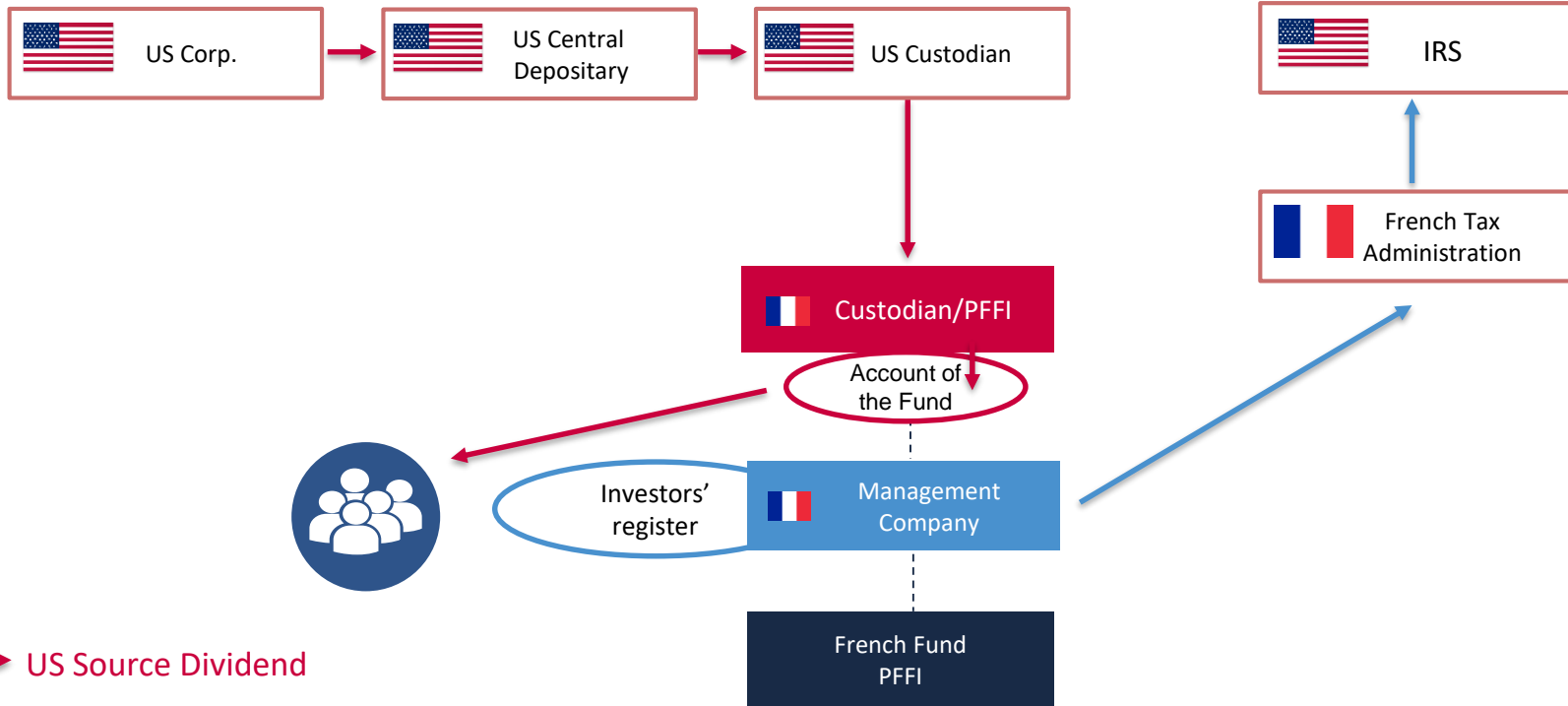
### Fund securities held through an FI



**The Fund/Management Company has NO Identification nor Reporting Obligations (FATCA – CRS)**

# 4.6 FATCA/CRS

## Fund securities recorded in the Fund register

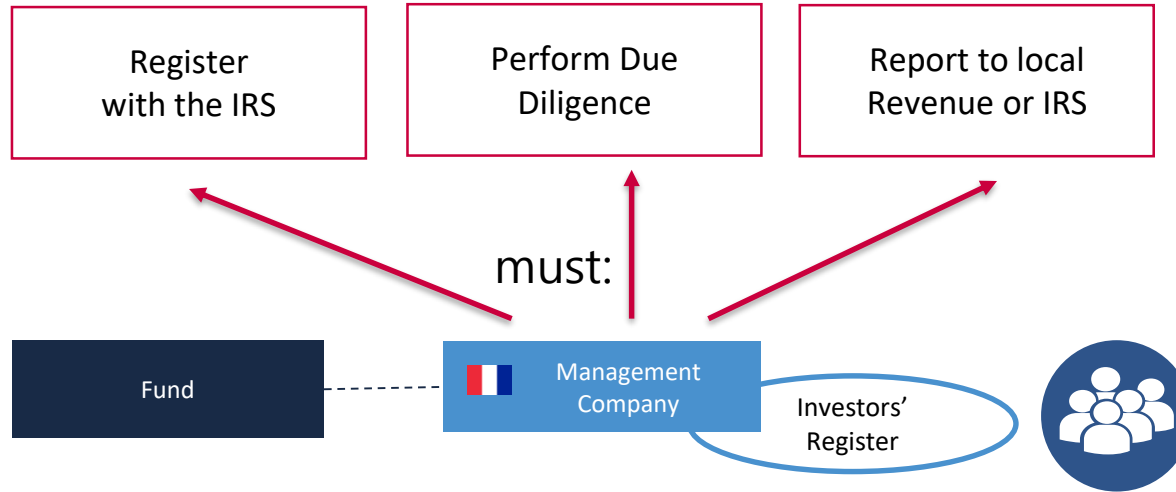


→ US Source Dividend

→ Tax Reporting

## 4.6 FATCA/CRS

### Fund securities recorded in the Fund register



- **The Fund must register and will have reporting obligations (KYC; FATCA/CRS Identification; AML ...)**
- The Fund can be sponsored by a “sponsoring entity” (PMC) in charge of registration, identification and reporting

# V. Taxation of managers





# 5.1 Taxation of investment managers

## Taxation of investment managers of hedge funds or PE funds



- Types of alternative investment funds:
  - **Private equity funds:**
    - Buyout funds
    - Venture capital funds
  - **Hedge funds:**
    - Traditional hedge funds
    - Activist hedge funds (mainly US)
- These funds (except traditional hedge funds) can realise **long term capital gains**

# 5.1 Taxation of investment managers

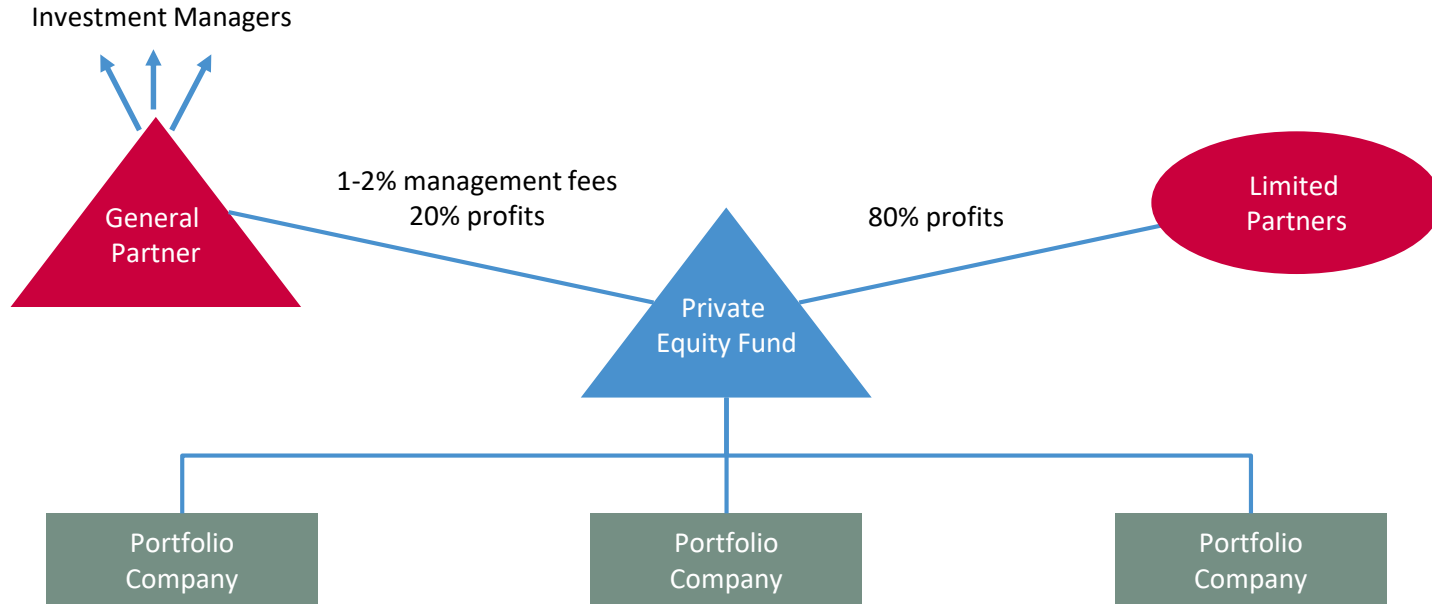
## Taxation of investment managers of hedge funds or PE funds



- Sources of **compensation for hedge fund/private equity managers**:
  - Management fees of 1-2% of NAV
  - 20% performance fees after preferred return (hurdles, high water marks, clawbacks)
  - Capital gains on co-investment
- Taxation of fund managers based on their legal form:
  - Taxation as **income** for **corporate fund managers**
  - Taxation as **business income** for **partnership fund managers**
- Alternative is to structure the performance fees (carried interest) as fund distributions (preference shares, leverage)

# 5.1 Taxation of investment managers

## Taxation of investment managers of hedge funds or PE funds



# 5.1 Taxation of investment managers

## Taxation of investment managers of hedge funds or PE funds



- Policy discussion about taxation of **carried interest**:
  - Fund managers provide their labor to the fund
    - Taxation as **business income**
  - The fund is tax transparent (or pass-through)
    - Taxation based on the fund tax attributes (**capital gains**)
- Capital gains tax treatment of carried interest sometimes possible depending on the nature of fund investments (long term)

# 5.1 Taxation of investment managers

## Taxation of investment managers of PE funds



- **US, UK:** acceptance of capital gains treatment, need to structure funds through partnerships
- **Switzerland:** acceptance limited to certain models
- **France:** acceptance under certain conditions
- **Germany:** income vs. gain and VAT depend on several factors
- **Canada:** tacit acceptance
- **Luxembourg:** usually structured as capital investment

# 5.1 Taxation of investment managers

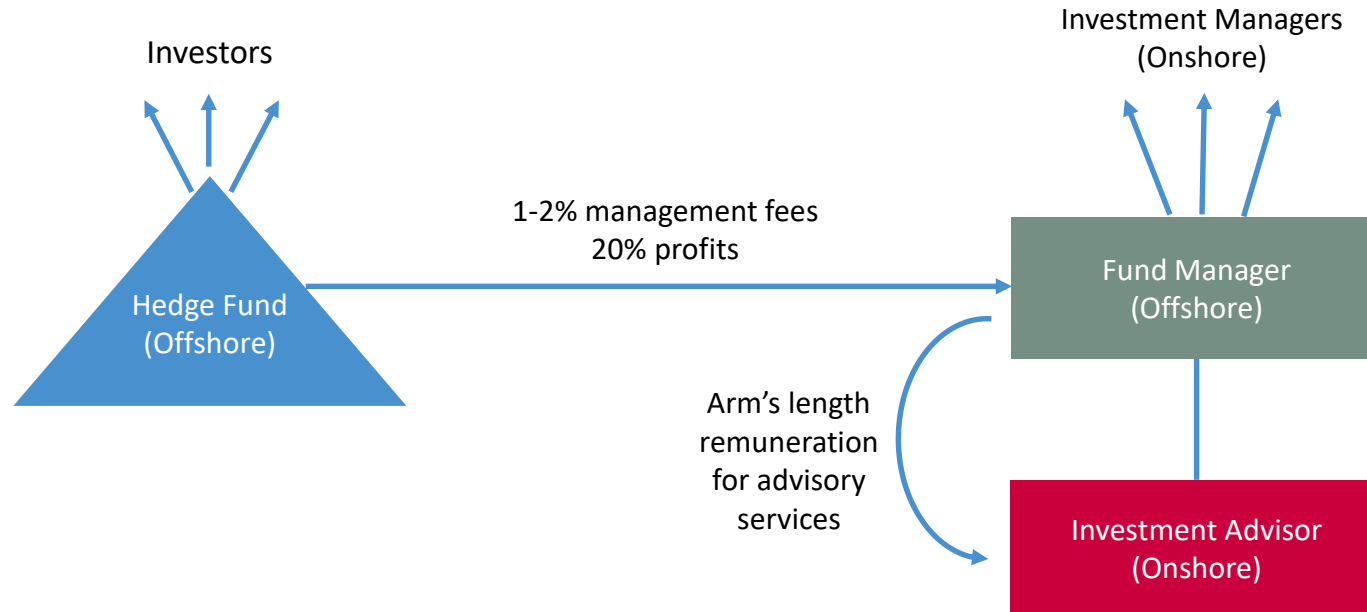
## Taxation of investment managers of hedge funds



- Certain hedge funds cannot qualify for **long term capital gains** treatment (e.g., synthetic investments)
- Advisory model with offshore fund manager and onshore investment advisor
- **Transfer pricing** allocation of the fees between group entities

# 5.1 Taxation of investment managers

## Taxation of investment managers of hedge funds



# 5.1 Taxation of investment managers

## Taxation of investment managers of hedge funds



- Challenges:
  - Does the retention of an **onshore investment advisor** create a tax exposure for the offshore fund?
    - Generally not an issue
    - Certain countries have safe-harbor rules
  - Does the use of an **offshore fund manager** create a tax exposure for the onshore investment managers or for the onshore investment advisor?
    - Practices vary among countries
    - Response depends on factual and economic circumstances



## 5.2 VAT/GST/Taxation of management fees

### VAT treatment of fund's management



- The **management** of special investment funds as defined by MS is **exempt** from **VAT** under the EU VAT directive (Article 135, 1, g) of Directive 2006/112/EU)
- Exemption subject to 2 conditions:
  - Service qualified as “**funds management**”
  - Rendered to a “**special investment fund**” (as defined by the EU MS)
- The Directive also allows MS to enact legislation that provides an option to charge VAT on otherwise exempt services

## 5.2 VAT/GST/Taxation of management fees

### Concept of fund



- Article 135, 1, g) provides:
  - MS free to define the concept of special investment funds in their local law
  - Obligation to comply with the objective pursued by the Directive
- ECJ\* : Not only UCITS should meet the definition of special funds but also those funds with identical characteristics or at least features that are sufficiently comparable to UCITS to be in competition with them
  - Comparability analysis
  - Guidelines of the VAT Committee issued after the 109th meeting (December 2017)
  - Application in some European countries

\* ECJ, Wheels Common Investment Funds Trustees and others C-424/11; ATP PensionService C-464/12 and Fiscale Eenheid X, C-595/13

## 5.2 VAT/GST/Taxation of management fees

### Concept of management



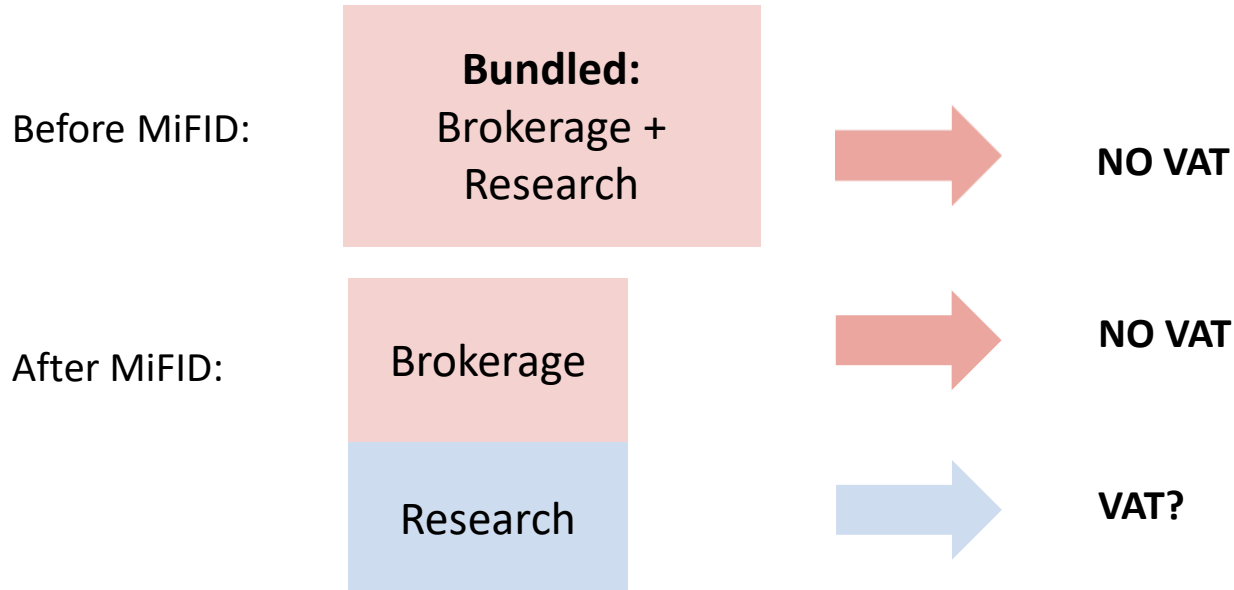
- The Directive does not define the concept of management
  - ECJ, **SDC** (C-2/95) and **Abbey National** (C-169/04)
    - The exemption is defined according to the **nature of the service** and **NOT** according to the **person** supplying or receiving the service
    - The service may be an **element of a service** in which various operators participate
    - Services covered by the exemption are services which form “a distinct whole, and are **specific to, and essential for,** the management of special investment funds”
  - ECJ, **GfBK** (C-275/11): “Services consisting of giving recommendations to a manager to buy and sell securities are intrinsically linked to this activity and have the effect of performing the essential and specific functions of the management of a SIF”

# 5.2 VAT/GST/Taxation of management fees

## Concept of management



Current hot topic: Research services under MiFID II



## 5.2 VAT/GST/Taxation of management fees



- Canada: management fees are **compensation** for a service
  - Canadian funds pay GST/HST on management fees (whether the provider is resident or non-resident). Not recoverable by fund since not engaged in “commercial activity”. Drag on fund performance
  - Non-Canadian funds do not pay GST/HST on services provided by a Canadian manager
- US: management fees are **compensation** for a service
  - No national VAT
  - State-level sales tax does not apply to this type of compensation

# Conclusion



## 6. Conclusion



- Tax neutrality
- Transparency
- Uniformity
- Technology