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INVESTMENT FUNDS:
INFORMATION OBLIGATIONS (FATCA),
TAX TREATY ENTITLEMENT AND RELATED ISSUES

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Today's agenda

- **Introduction**
  - The CIV industry
  - Typical CIV structures in the panelists' jurisdictions
- **Treaty entitlements for CIVs**
  - General overview of the current state of the debate
  - Panel discussion
- **FATCA**
  - Meaning of FATCA for CIVs
  - The globalization of FATCA
  - Panel discussion
- **Other tax issues affecting CIVs**
  - The Santander case
  - Taxation of investment managers

INTRODUCTION

Introduction: *What are funds and why are they attractive to investors?*

Funds are groups of investors pooling their resources to invest in financial assets, principally securities

By pooling resources they gain the benefit of being a larger investor allowing them to:

- invest in a wider range of financial products
- spread their risk
- have experts advise on their investments and
- have specialist service providers/administrators look after the fund

Introduction: *Major fund jurisdictions*

The US & Europe accounted for 77.5% of the worldwide distribution of investment fund assets at end March 2012 (48.9% and 28.6% respectively)

Market share of the 10 largest domiciles in the world market (excluding non-UCITS)

- US (48.9%)
- Luxembourg (8.9%)
- Brazil (5.9%)
- Australia (5.5%)
- France (5.4%)
- Ireland (4.2%)
- Japan (3.7%)
- Canada (3.6%)
- UK (3.3%)
- Germany (1.1%)

Introduction: *Major fund jurisdictions*

Non-UCITS		UCITS		
Country	**Assets € millions**	**Country**	**Assets € millions**	**Market share in %**
Germany	882,377	Luxembourg	1,704,978	31.16%
Luxembourg	327,099	France	1,080,382	19.74%
France	303,513	Ireland	754,903	13.79%
Ireland	215,672	UK	602,269	11.01%
UK	142,471	Germany	221,914	4.06%
Switzerland	56,851	Switzerland	205,222	3.75%
Italy	55,218	Spain	152,792	2.79%
Spain	6,911	Italy	149,371	2.73%
Sweden	3,137	Sweden	134,790	2.46%
Others	201,262	Others	465,799	8.51%
Total:	**2,194,511**	**Total:**	**5,472,420**	**100%**

(EFAMA Q3 2011/Q1 2012 statistics)

Introduction: *What are regulated collective investment vehicles*

In Europe, these usually refer to UCITS and non UCITS

In the US, they refer to, for example registered mutual funds, closed-end funds, private funds and REITs

In much of Asia, UCITS are commonly used for local investors

UCITS

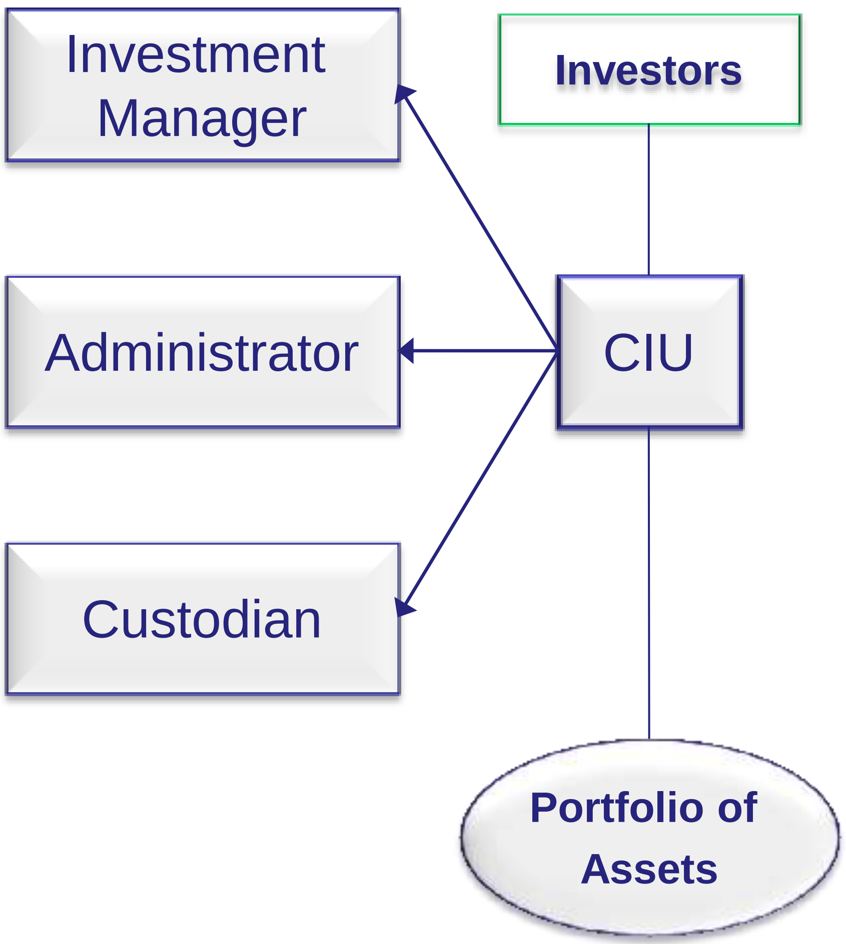
- Highly regulated
- Must be open-ended
- Can avail of a “single passport” throughout EU for sale of the units

Non-UCITS

- Sophisticated investors (institutional and high net worth)
- May employ more complex investment strategies posing greater risk
- SIFs/QIFs offer flexibility to employ alternative investment strategies (e.g., private equity and real estate investment funds)

Types of investment vehicles e.g. variable capital companies, trusts, partnerships, limited partnerships, contractual arrangements, etc.

Introduction: *Key players in a CIU Structure*

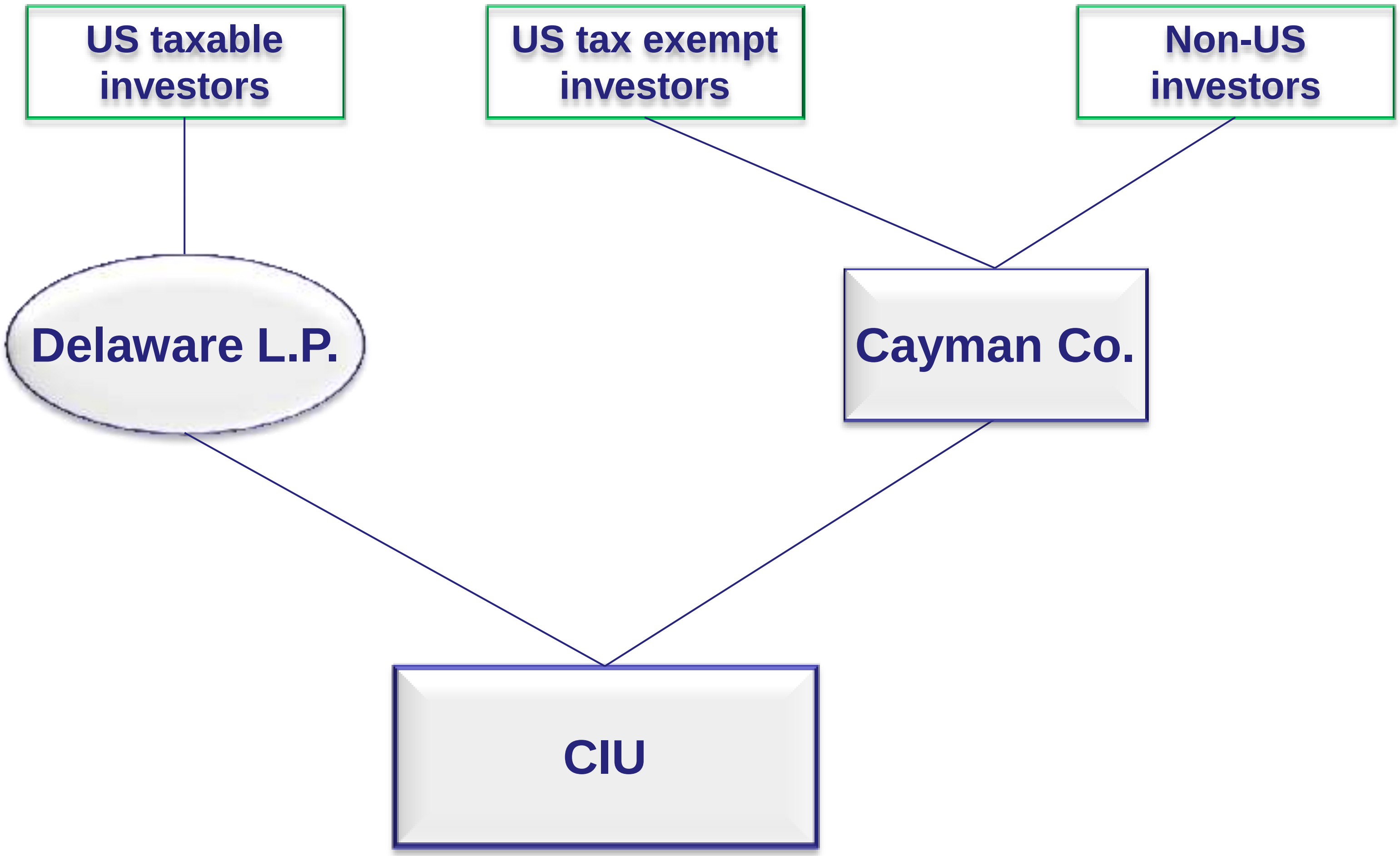


- ***Investment Manager***: manages the portfolio
- ***Administrator***: maintains the accounts and records of the fund
- ***Custodian/Trustee***: safekeeping of assets

Others

- ***Promoter***: the originator, often the investment manager
- ***UCITS management company***: management of fund risk and compliance
- ***Prime broker***: facilitates derivative transactions
- ***Listing Agent:*** Lists the fund on a recognised stock exchange
- ***Sub-custodian***: e.g. where holding assets in another jurisdiction

Introduction: *CIU investor level*



Introduction: *Typical fund structure in Hong Kong*

Regulated Funds

- Mutual funds (corporate) or unit trusts authorised by the Hong Kong Securities and Futures Commission (« SFC »)
- Open-Ended
- In practice, many funds are domiciled off-shore and may be UCITS II vehicles
- Note: for regulatory reasons, UCITS IV vehicles are not viable in Hong Kong

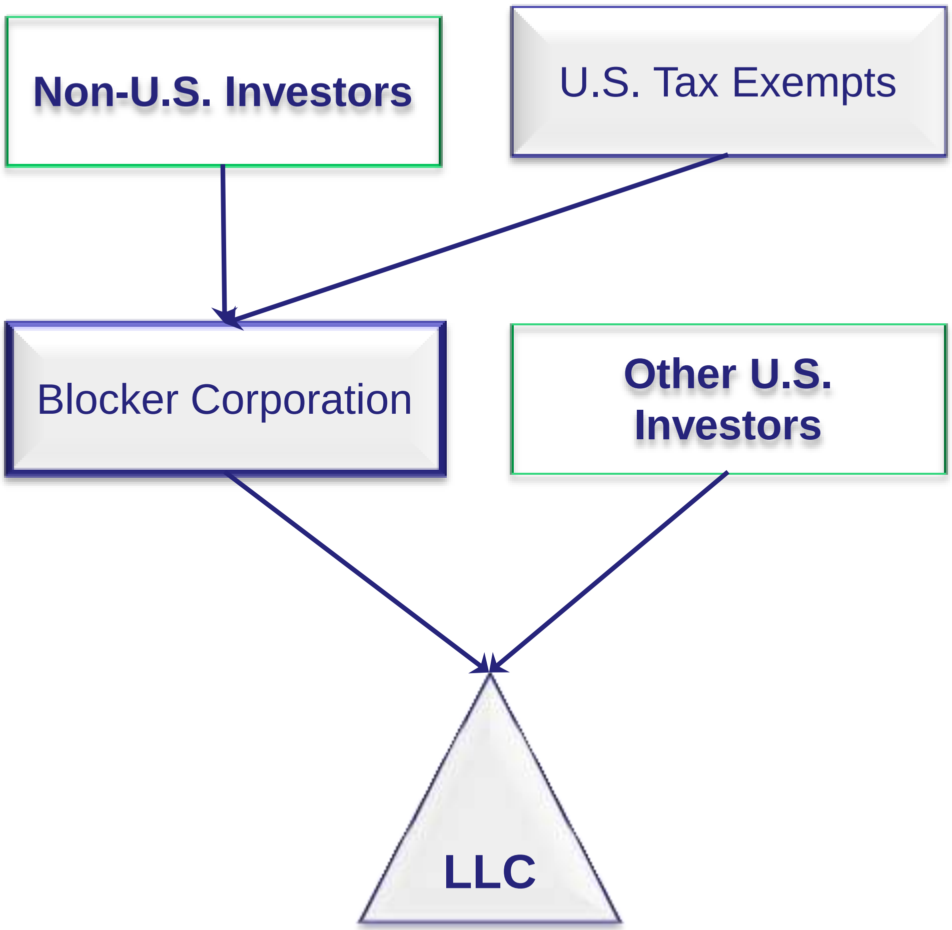
Introduction: *Typical fund structure in Hong Kong*

Taxation

- **General Rules**
  - Funds are subject to 16.5% profits tax, although most funds qualify for exemption
  - Exemptions (Onshore and Offshore)
    - Mutual funds or unit trusts authorised under the Securities and Futures Ordinance; or
    - « Bona fide » Mutual funds, unit trusts, or similar collective investment vehicles (in the IRD’s opinion)
  - Offshore exemption: « non-resident » funds that derive profits only from qualifying transactions
    - Key for unregistered funds

- **Advisers**
  - Subject to standard 16.5% income tax
  - Cayman Adviser and Hong Kong Manager Structure
  - Recent IRD enforcement actions and transfer pricing

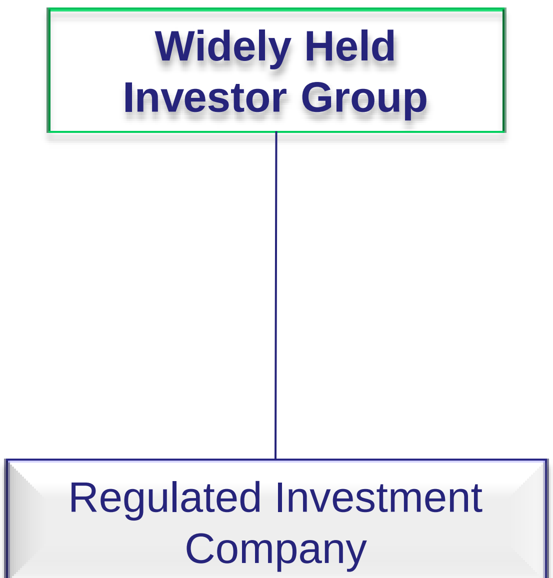
Introduction: *Typical fund structure in the United States*



Hedge Funds

- Non-U.S. investors remain outside U.S. tax reporting net
- Eliminates an investment in a U.S. situs asset by non-U.S. individuals, thereby reducing exposure to U.S. estate tax
- Allows pass-through of income and gains to U.S. investors and to Blocker Corporation if L.L.C. has less than 100 members

Introduction: *Typical fund structure in the United States*

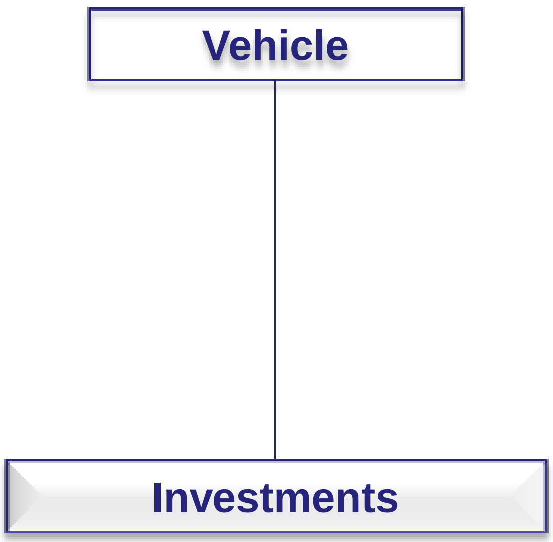


Regulated Investment Company

- Must be registered under the Investment Company Act of 1940
- ≥90% of income must be attributable to dividends, interest, gains and the like
- Must meet specified asset-diversification test
- ≥90% of income and gains must be distributed annually
- A deduction is allowed to the mutual fund for the distributions
- The capital gain dividends, and for certain funds, exempt interest dividends retain the same character in the hands of the recipient
- Investors may claim credits for foreign income taxes paid by the mutual fund, within certain limitations
- Prior to 2012, the portfolio debt exemption could apply to dividends attributable to “portfolio interest”

Introduction: *Typical fund structure in the United Kingdom*

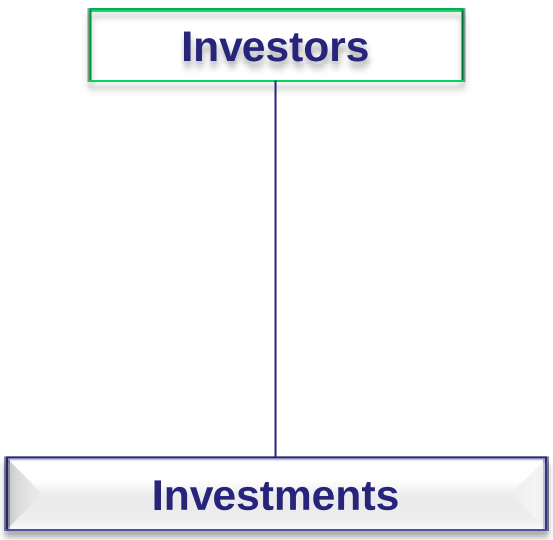
Vehicles



- **Closed-ended corporate**
  - Investment trust
- **Open-ended**
  - Authorised unit trust
  - OEICs
- **Tax**
  - Exemption from CGT
  - Taxed as corporates

Introduction: *Typical fund structure in the United Kingdom*

Investors



- **Bond funds**
- **CGT on disposals**
- **Distributions**
  - Tax credit for individuals
  - Exempt for corporates

Introduction: *Typical fund structure in the United Kingdom*

Variants

- **Offshore funds**
- **Tax-elected “transparent” funds**

Introduction: *Typical fund structure in Germany*

Regulated funds (German Investment Act)

- open ended
- UCITs and certain non-UCITs
- investment funds (*Sondervermögen*)
  - contractual type
- investment companies (*Investmentaktiengesellschaften*)
  - corporate type
  - special tax regime

REITs

- special regulatory and tax regime
- corporate structure (*Aktiengesellschaft*)
  - corporate type
  - publicly traded
- not yet broadly accepted by the market
  - 4 German REITs quoted on *Deutsche Börse REITs* as of July 2012

Introduction: *Typical fund structure in Germany*

Unregulated funds

- typically closed ended
- various types
  - real estate, private equity, renewable energy, shipping …
- (limited) partnerships
  - most common structure
  - mostly *GmbH & Co. KG*
- corporate entities
  - less common
  - *GmbH*, *Aktiengesellschaft*
- taxation: general rules
  - partnerships ➔ tax transparent
  - corporate entities ➔ taxable/withholding tax on distributions

Completely new system on the horizon ➔ implementation of AIFM-D

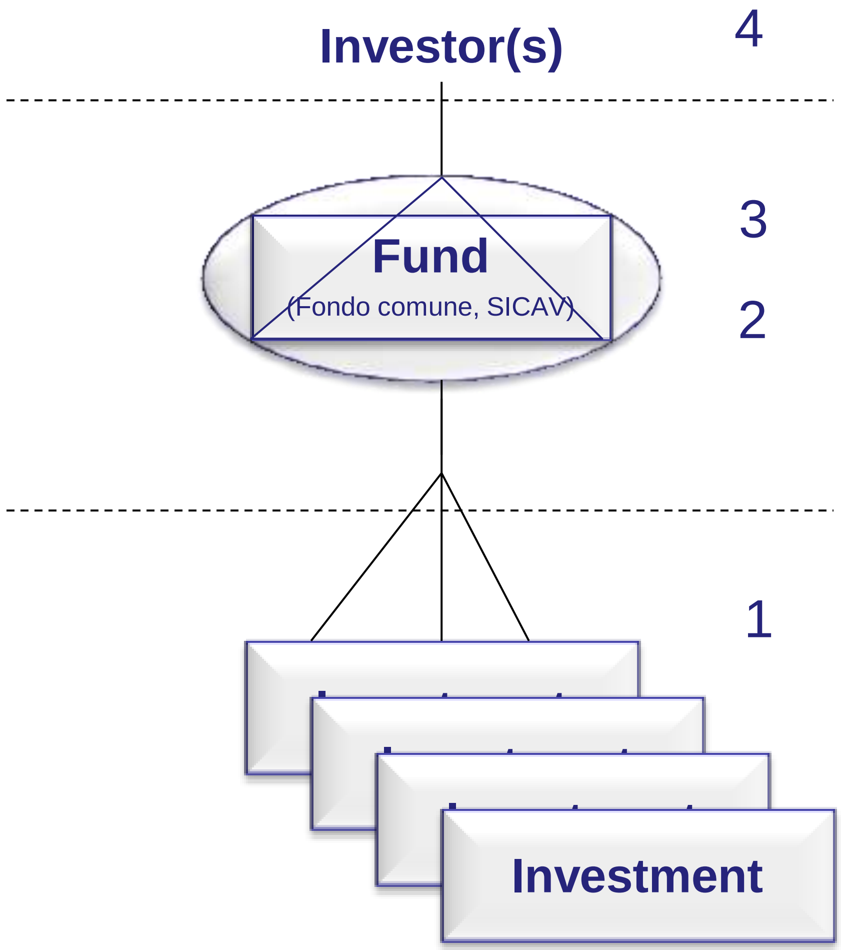
Introduction: *Typical fund structure in Germany*

Certain tax aspects of regulated funds

- Quasi-transparent treatment
  - generally investment funds and investment companies are taxable entities (i.e. opaque), but exempted from tax
  - taxation of distributed proceeds and certain retained proceeds
  - with respect to certain items of income (e.g. dividends and capital gains) investors will be treated as if they invested directly
  - distributed and certain retained proceeds generally subject to withholding tax

- Non-German investors investing in German regulated funds
  - pursuant to most German tax treaties taxable proceeds of a German regulated fund will be treated as dividends on investor level
  - generally 15 % withholding tax applicable (no reduced withholding tax)
  - domestic withholding provisions provide for certain exemptions from withholding tax for non-resident investors

Introduction: *Typical fund structure in Italy*



- **1. Local taxation in source country**
  - Treaty protection
  - Dividend withholding tax (reduced or no withholding tax depending on source State)
- **2. Income taxation at Fund level**
  - Not subject to tax
- **3. Source taxation at Fund level**
  - 20% withholding tax (exemptions apply)
  - Treaty protection (subject to conditions)

Introduction: *Typical fund structure in Italy*

Taxation and Residence

- As general rule, Italian UCITS are persons liable for corporate income tax (IRES), even if exempt (subject to the condition that the UCITS is subject to regulatory supervision)

- In many cases, financial income derived by Italian UCITS is exempt from withholding or substitute taxes
  - Capital gains on minority holdings
  - Dividends
  - Proceeds under REPOs or securities lending transactions
  - Interest on certain bonds (e.g., government bonds, bonds issued by resident listed companies and banks, bonds issued by non-Italian resident companies)

- UCITS established in Italy are considered Italian resident for the purposes of Italian domestic tax laws and any applicable double tax treaty

Introduction: *Typical fund structure in Italy*

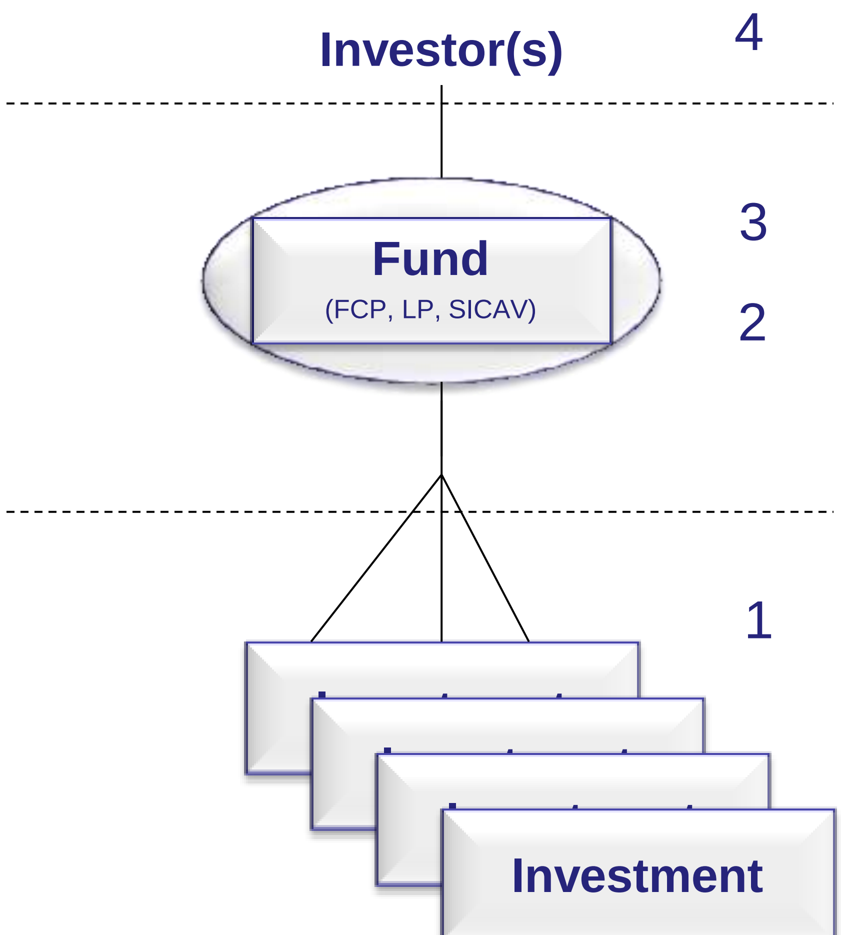
Taxation at the level of the fund

- Major reform of investment funds taxation in 2011

- Before 1 July 2011, the annual increase in value of each fund (difference of the NAV) was subject to a 12.5% substitutive tax, to be applied by the Italian management company

- After 1 July 2011, taxation does not apply at the level of the fund, but at the level of the investors, via the application of a 20% substitute tax
  - Exemptions apply (e.g., white list investors, EU investors, etc.)

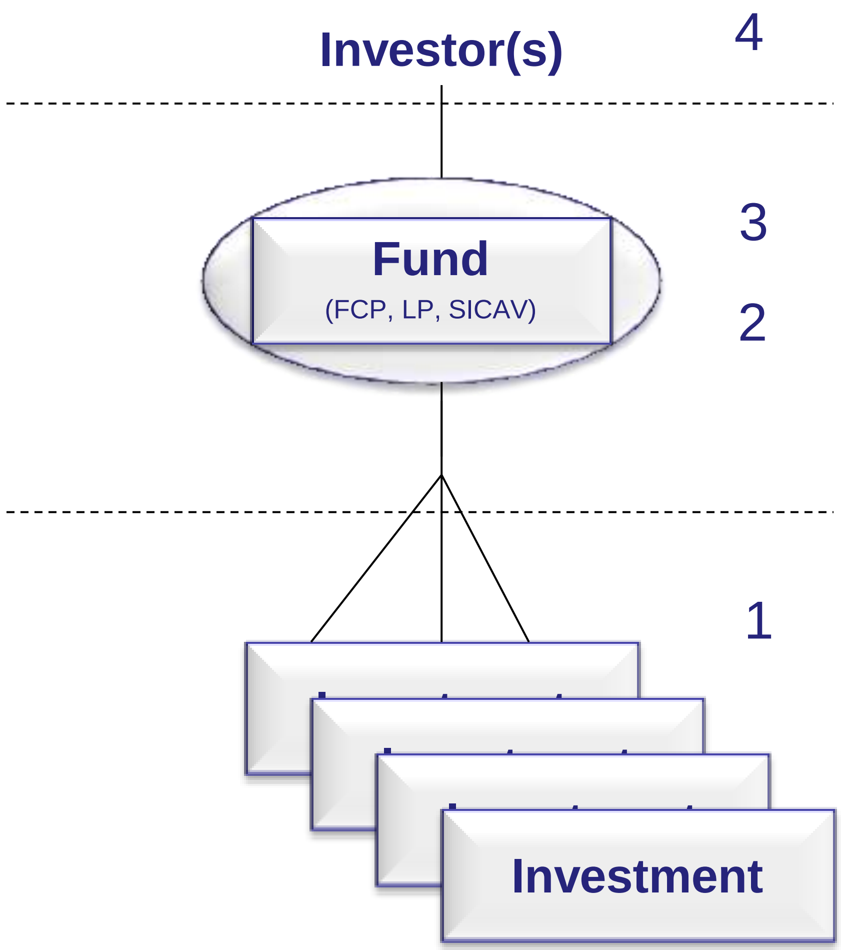
Introduction: *Typical fund structure in Switzerland*



Types of CIVs

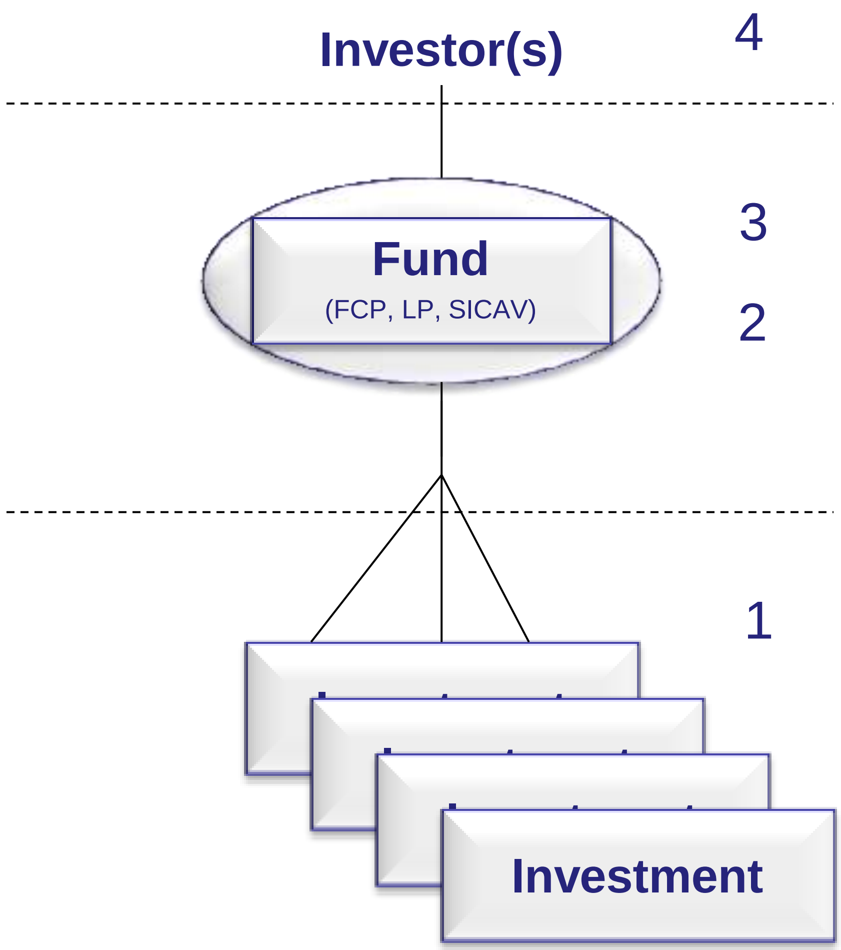
- Regulated and non regulated CIVs
  - CIVS governed by Swiss Collective Investment Vehicles Act (KAG)
    - Switzerland: FcP, SICAV, LP, SICAF
    - foreign CIV within the meaning of Art. 119 KAG
- Open ended and closed ended CIVs
  - open ended: FcP, SICAV
  - closed ended: LP, SICAF
- Incorporated and non incorporated CIVs
  - incorporated: SICAV, SICAF
  - not incorporated: FcP, LP
- Transparent and opaque CIVs
  - transparent (for corporate income tax purposes): FcP, SICAV, LP
  - Opaque: SICAF

Introduction: *Typical fund structure in Switzerland*



1. **Local taxation in source country**
   - **Swiss Withholding tax (35%)** on dividends and certain types of interest (e.g. bonds)
   - Swiss CIVs can recover Swiss withholding tax (irrespective of residency of investors)
   - Foreign CIVs are usually not entitled to claim DTT benefits; certain **bilateral agreements** provide benefits of DTT

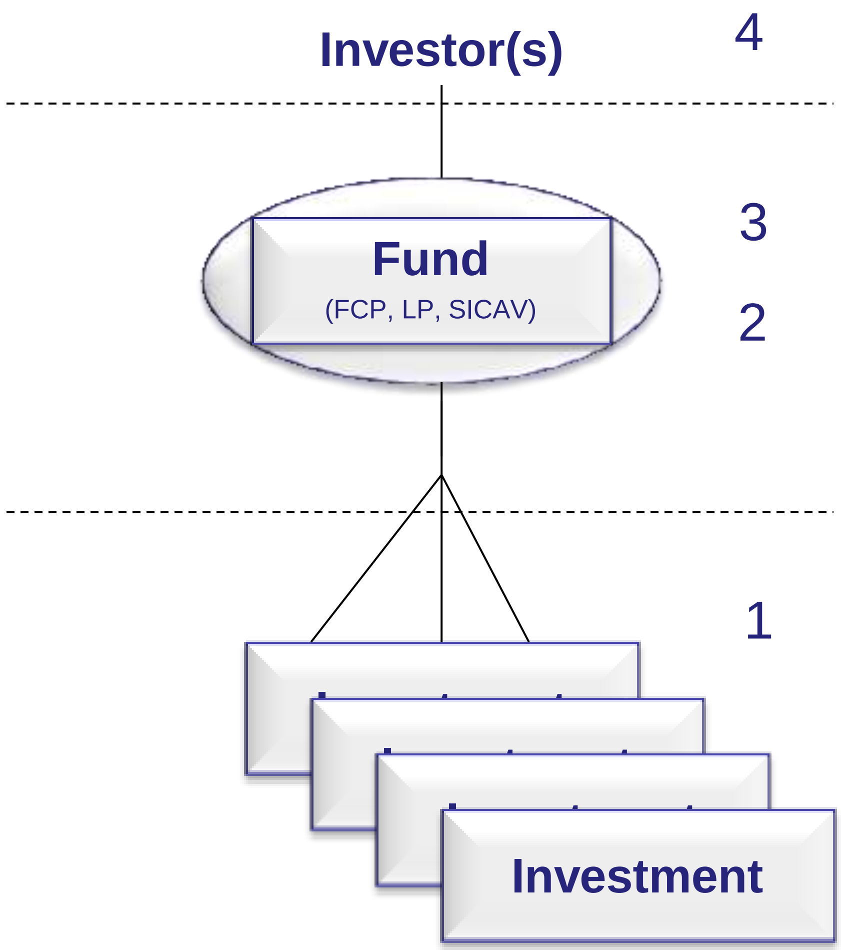
Introduction: *Typical fund structure in Switzerland*



2. Taxation at Fund level

- CIVs not subject to income tax
- Exceptions
  - CIVs with directly held real estate
  - SICAF: taxed as corporation
- No issuance stamp duty (exception: Issuance of shares of SICAF)
- Swiss CIVs are treated as exempt investors for transfer stamp duty

Introduction: *Typical fund structure in Switzerland*

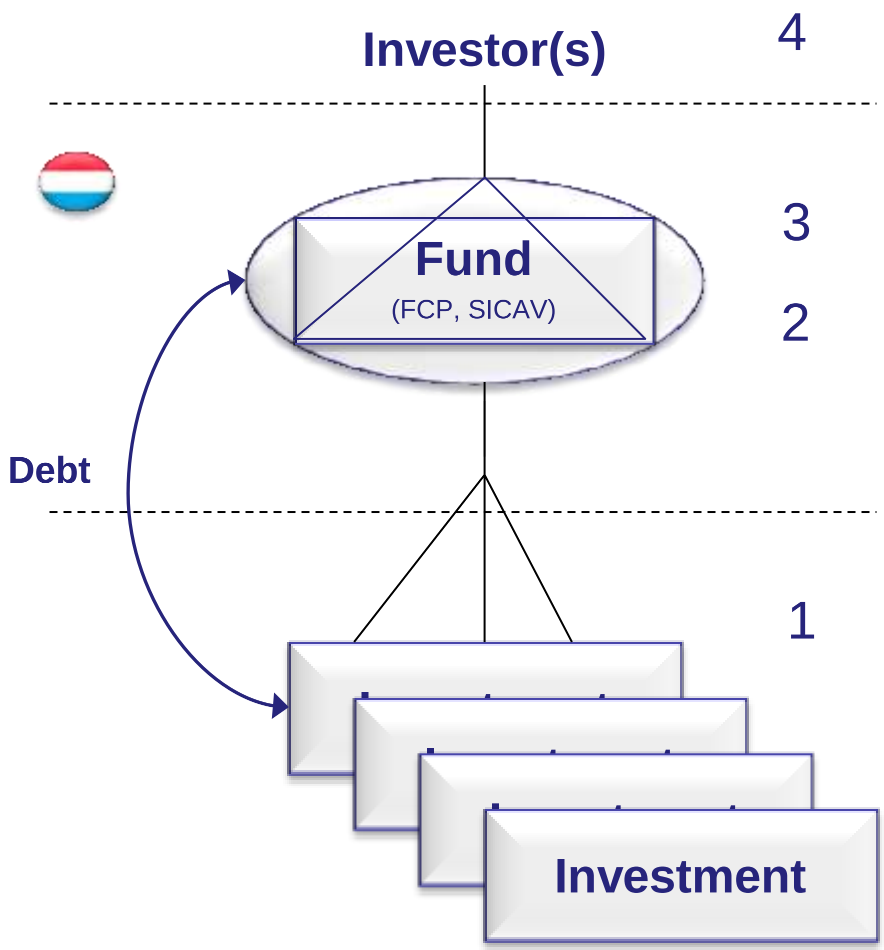


3. Source taxation at Fund level

FcP, LP, SICAV:

- **35% withholding tax on earnings (distributions and accumulated profits):**
  - Distributing funds (obligation to distribute ≥ 70% of net earnings): Withholding tax on distributions only
  - Retaining funds: Withholding tax on earnings (retained as well as distributed)
- **No withholding tax on capital gains and income from directly held real estate**
- **No withholding tax for foreign investors if 80% of income of fund derives from foreign assets ("Affidavit-procedure").**
- **Refund of 35% Swiss Withholding tax:**
  - Recovery for domestic investors based on internal rules
  - If CIV is not eligible for notification procedure, recovery for foreign investors based on DTT

Introduction: *Typical fund structure in Luxembourg*

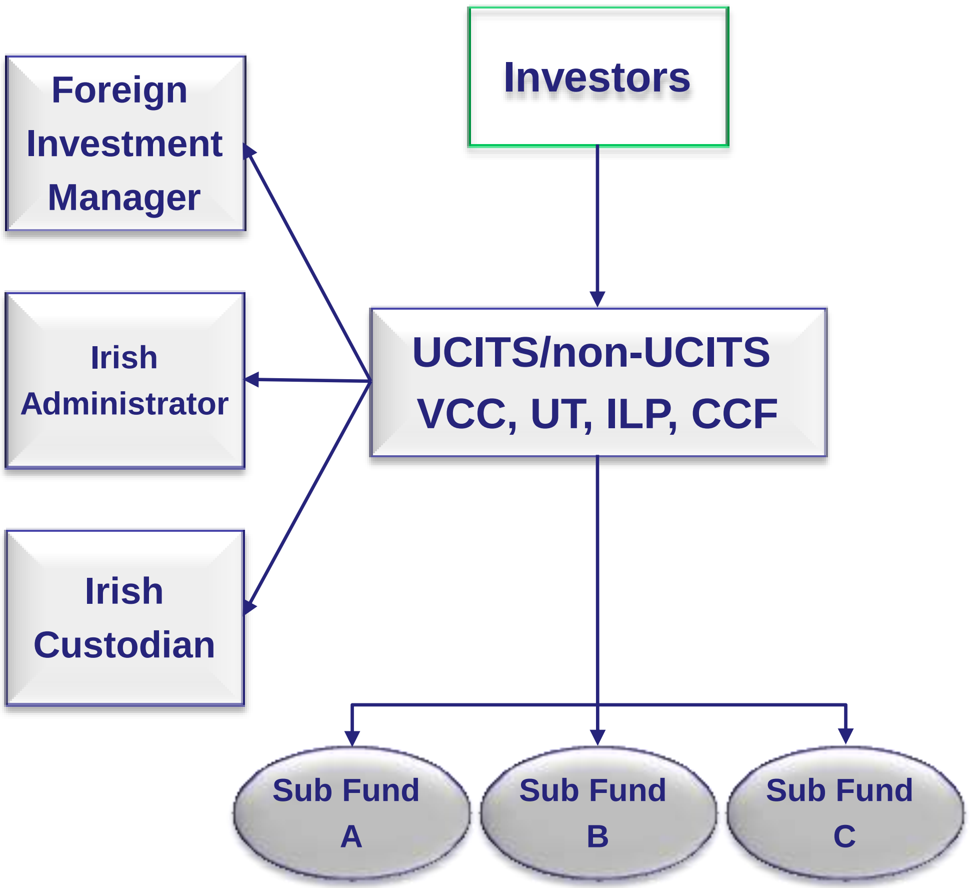


1. **Local taxation in source country**
   - Treaty protection (yes/no)
   - Dividend withholding tax (yes/no/reduced)
   - Interest and principal repayments (not) subject to tax
   - Taxation of capital gains (yes/no)
   - (EU) participation exemption regime (yes/no/cond.)

2. **Income taxation at Fund level**
   - Not subject to tax

3. **Source taxation at Fund level**
   - No withholding tax (except if savings tax)
   - Treaty protection (not needed)
   - No capital gains taxation (upon redemption)
   - No exit/liquidation taxation

Introduction: Typical fund structure in Ireland



Types of funds

- UCITS
- Non UCITS

Types of Vehicles

- Unit trust, variable capital company, investment limited partnership, common contractual fund

Treaty entitlement

- Resident in Ireland
- except CCF (tax transparent)

Irish taxation

- Income and gains exempt
- No WHT or exit tax for non-residents
- Indirect tax exemptions

TREATY ENTITLEMENTS

Treaty entitlements for CIVs

Introduction of the Topic

- The objective is to achieve tax neutrality for investments through a CIV
- Investors investing through a CIV should not be in a worse tax position, compared to a direct investment in the target
- In general, purely domestic investments through a CIV are dealt with in the tax law of the respective jurisdiction, generally ensuring taxation only on one level (CIV or investor)
- Bilateral or triangular , international situations are frequently more complex

Treaty entitlements for CIVs

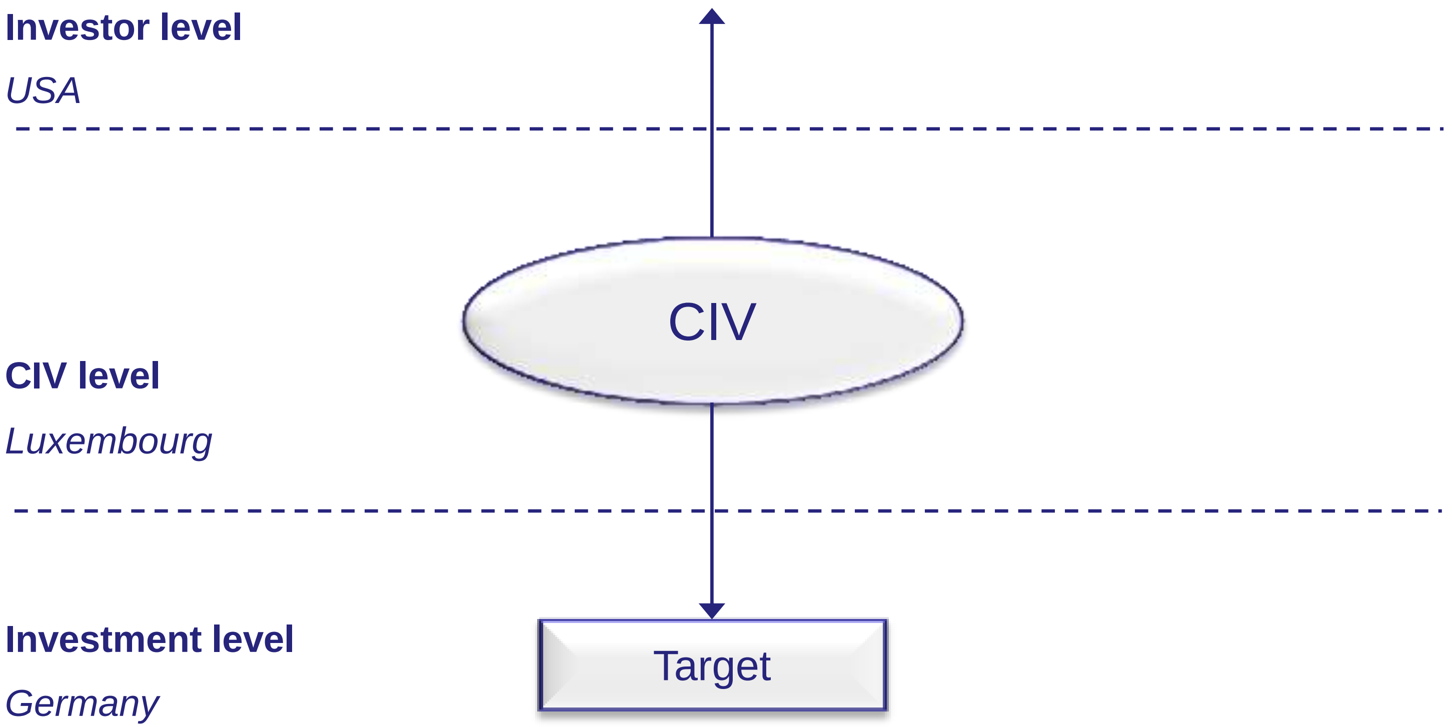
Tax inefficiencies and market responses

- Main issue: WHT at target level is frequently a final cost for the CIV
- Treaty relief claims for and on behalf of investors are often burdensome or impossible

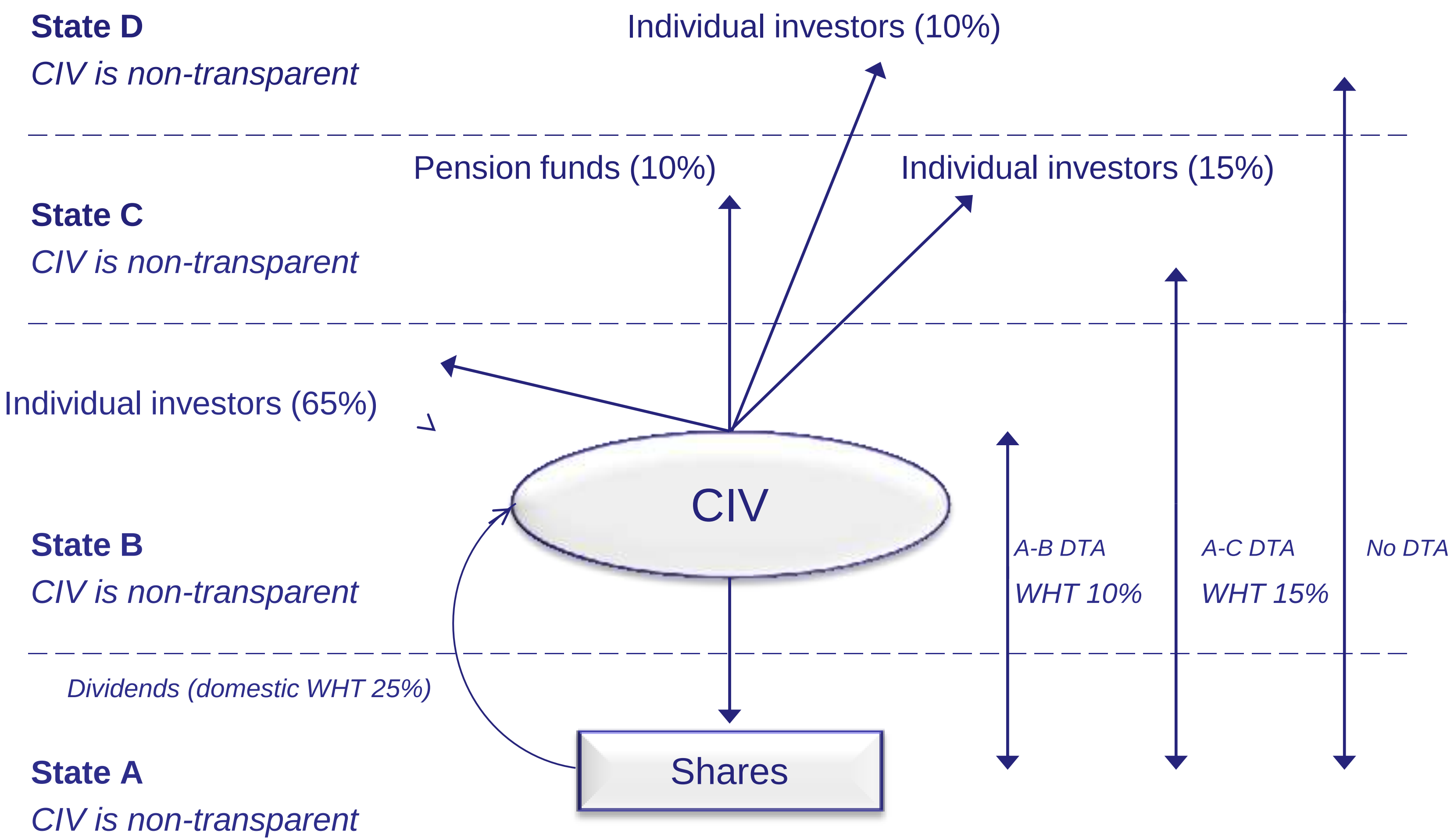
- Fund structure try to minimize tax inefficiencies arising from lack of treaty entitlement
- Derivatives and other cost effective instruments are chosen as targets
- The flexibility and cooperation of tax administrations play a significant role

Treaty entitlements for CIVs

Example for a tri-national CIV structure



Treaty entitlements for CIVs



Treaty entitlements for CIVs - are CIVs entitled to treaty benefits?

The three main corner stones

- Is the CIV a person covered by the treaty?
- Is the CIV a resident of a state party to the treaty?
- Is the CIV the beneficial owner of the income to be covered by the treaty?

Article 1 of the OECD Model Tax Convention provides

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

Treaty entitlements for CIVs – is the CIV a person covered by the treaty?

Corporate CIVs (e.g. a Luxembourg SICAV)

Contractual CIVs (e.g. a Luxembourg FCP)

Trust-type CIVs (e.g. a UK unit trust)

OECD Commentary to the Model Tax Convention:

- “the term “person” includes any entity that, although not incorporated, is treated as a body corporate for tax purposes. Thus, e.g. a foundation (fondation, Stiftung) may fall within the meaning of the term "person". Partnerships will also be considered to be "persons" either because they fall within the definition of company" or, where this is not the case, because they constitute other bodies of persons.”

Accordingly, all above CIV types should in principle be a person for treaty purposes

Treaty entitlements for CIVs – is the CIV a resident of a state party to the treaty?

In order for a CIV to be a resident of a state party to a treaty, the CIV should be, at least in theory, be liable to taxes in that state

Article 4 OECD Model Tax Convention:

- "1. 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, and also includes that State and any political subdivision or local authority thereof.(…)"

- A subjective or objective exemption, or the acknowledgment of tax transparency of a CIV does not exclude its residency status under a treaty, as long as the CIV falls within the scope of application of the tax laws of the state in which it is established and would, if the exemption were not to apply, be taxable on its worldwide income

Accordingly, effective taxation of the CIV is not required

Treaty entitlements for CIVs – is the CIV the beneficial owner of the income to be covered by the treaty?

OECD Model Tax Convention Commentary:

- "The term "beneficial owner" is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance. (…) a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties."

Focus on the functions, tasks and decision power of the CIV:

- Number of investors
- Control over the investment policy
- Possibility of investors to directly hold the investments

Limitation of benefits and anti-abuse issues

Current pathways to resolve double taxation due to the treaty entitlement of CIVs

Award treaty entitlement to the CIV itself

- The CIV is a person, a resident and the beneficial owner of the income under the treaty
- Fully or partial treaty benefits?
  - Investor-by-investor
  - Award of benefits on a percentage basis
  - Only for investors of the resident state of the CIV (i.e. only bilateral cases) or also for investors resident in third states (i.e. tri-/multilateral cases)
  - The “equivalent beneficiary “ theory

No treaty entitlement for the CIV – Transparency approach

- CIV will be only considered as a intermediary
- CIV will claim benefits for an on behalf of the investor

Current pathways to resolve double taxation due to the treaty entitlement of CIVs

Bilateral (or multilateral) harmonization of the CIV definition by an explicit qualification in the treaty (or in a protocol):

- “For purposes of this treaty, the term “collective investment vehicle” means, in the case of [state A], a [ ] and, in the case of [state B], a [ ], as well as any other investment fund, arrangement or entity established in either Contracting State which the competent authorities of the Contracting States agree to regard as a collective investment vehicle for purposes of this paragraph.”

Award treaty entitlement to the CIV itself

Examples include Luxembourg SICAVs under a number of treaties (e.g. Hong Kong, Germany, Spain, Singapore, Turkey, UAE)

Full or partial treaty entitlement to the CIV? – the "equivalent beneficiaries" theory

- Investors resident in the same state as the CIV
- Investors resident in another state, in case the residency state of the investor assures the taxation of the income received from the CIV and participates in the exchange of information in tax matters

Anti-abuse provision: only award treaty benefits, if the treaty rate of the investor investing directly is at least as high as the treaty rate of the CIV

Award treaty entitlement to the CIV itself

The determination of the threshold of eligible beneficiaries is crucial:

- If substantial proportion (e.g. investors representing at least 90% of the NAV) of CIVs investors is treaty eligible, the entire CIV will be considered treaty eligible
- Purely proportionate approach burdensome for CIVs (recurring investor verification, tax rate surveys etc.)
- An investor-by-investor approach is even more burdensome/unpractical for CIVs

"If at least [90] percent of the beneficial interests in the collective investment vehicle are owned by equivalent beneficiaries or residents of the CIV state, the CIV shall be treated as an eligible entity…"

No treaty entitlement for the CIV – Transparency approach

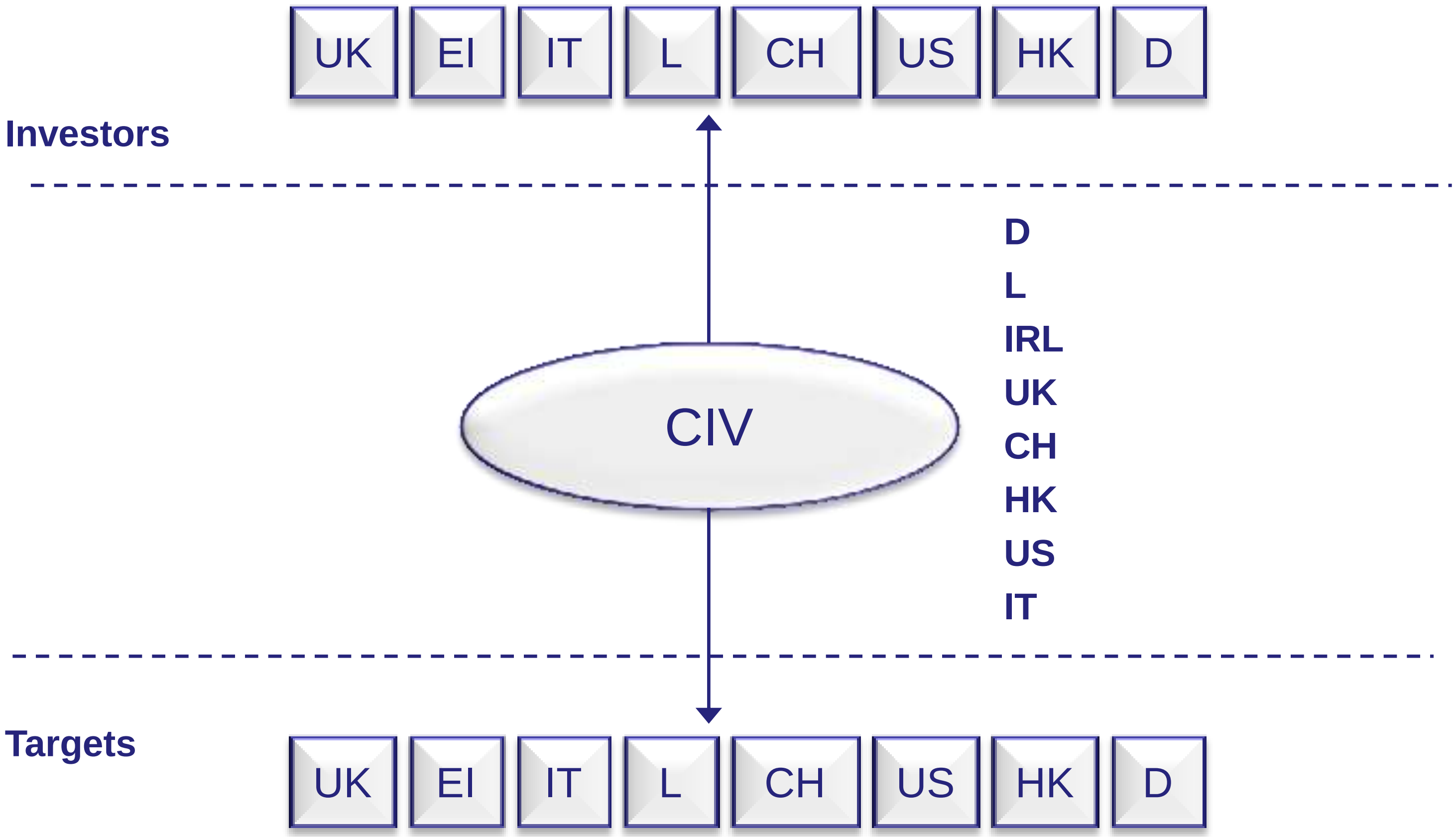
CIV is considered a mere intermediary, not a treaty eligible entity out of its own right

The transparency of the CIV ensures that treaty benefits and treaty WHT rates are not lost for

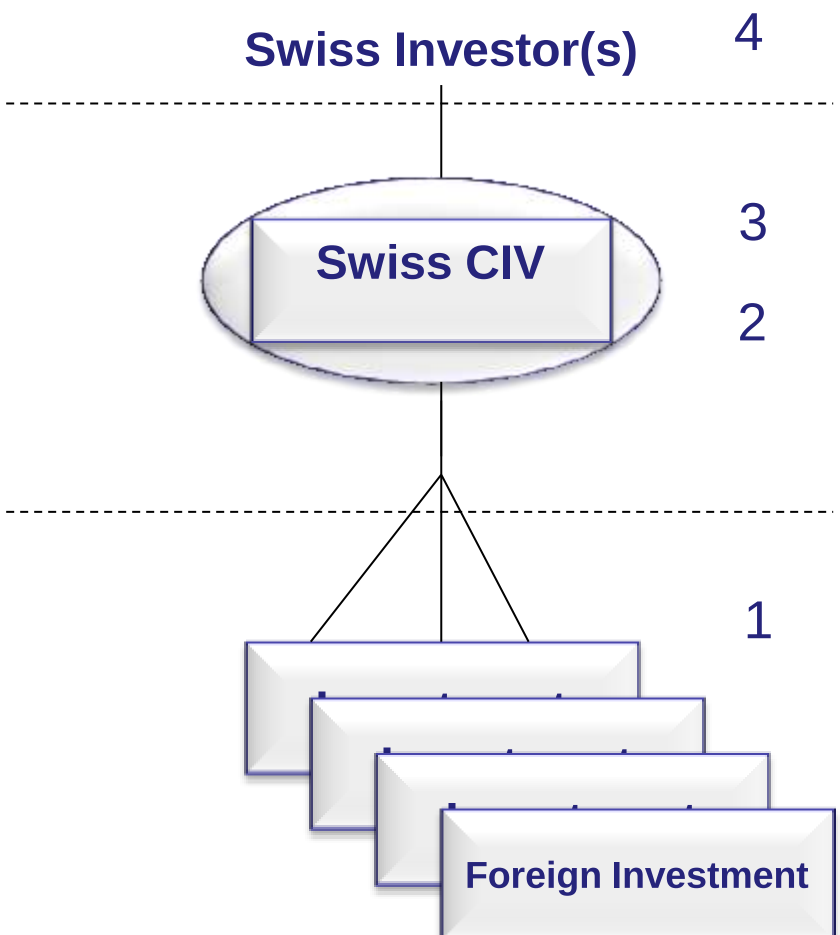
- Investors of the state in which CIV is established under the treaty between the state of residence of the investor and the CIV and the target country
- Investors of the third states under the treaty between the state of residence of the investor and the target country

In general, the transparency approach is the most attractive to the investor, as no tax leakage at the CIV level can occur and the “equivalent beneficiary” restrictions to beneficial treaty rates do not apply

National experiences – the general setting



Treaty entitlements: *Switzerland*



Switzerland has concluded bilateral agreements with several countries granting Swiss FcPs:

<u>Refund</u> of foreign withholding tax:

- *Denmark / Germany / France / UK / Netherlands / Norway / Austria / Sweden / Spain*

<u>Reduction at source</u> of foreign withholding tax:

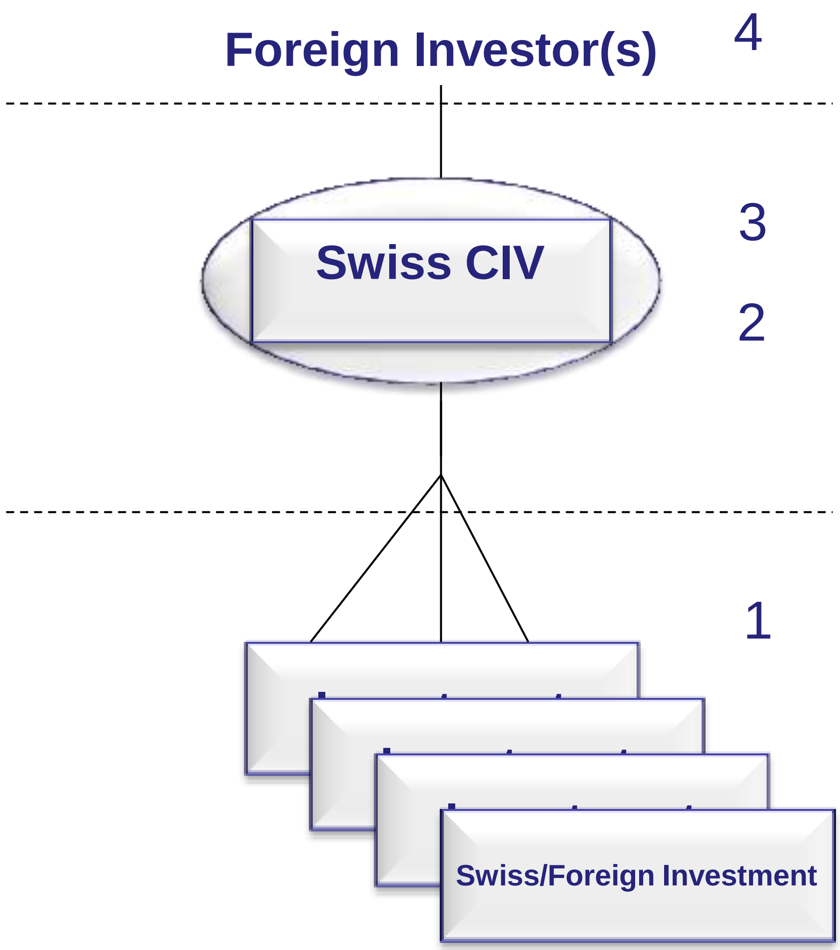
- *Australia / Japan / Canada*
- Portfolio rate for dividend income (residual rate of 15%)

FcP does not claim benefits of treaty on its own behalf: Treaty benefits only for **Swiss resident investors**.

Application of the agreements to SICAV and LP (introduced in 2007)?

- Certain for new agreements: *Denmark / UK*
- According to practice for agreements with *Australia / Japan / Canada*

Treaty entitlements: *Switzerland*



Foreign Investors in Swiss CIVs

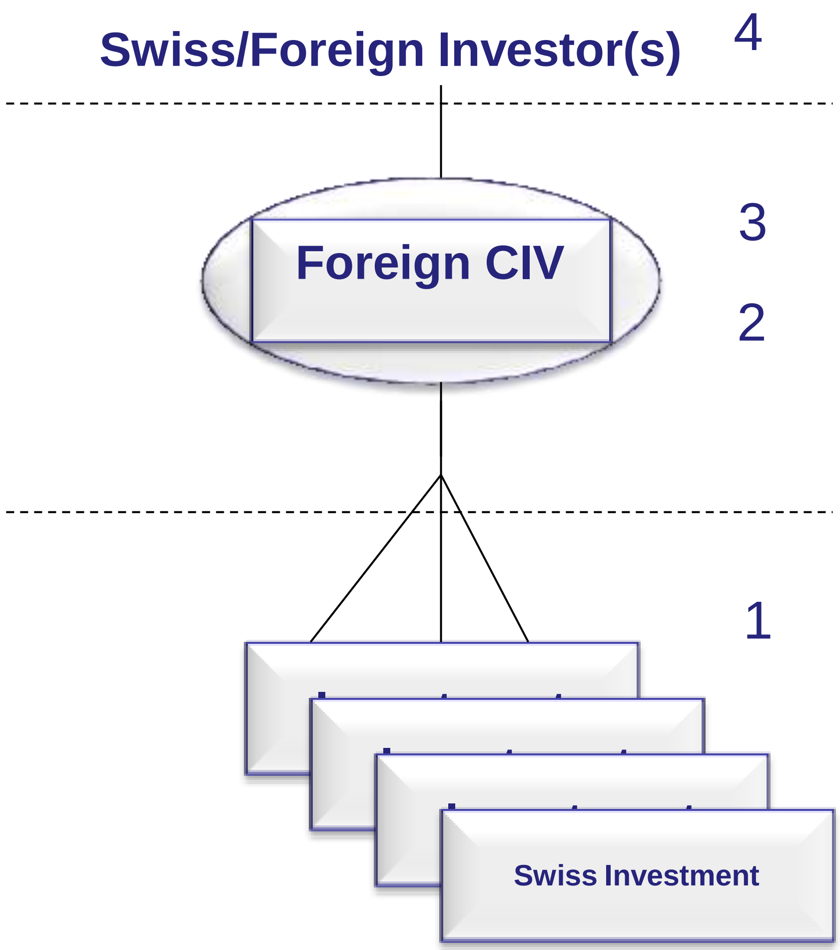
CIVs with 80% foreign source income

- Distributions (and accumulated profits) of Swiss FcP, SICAV and LP are subject to 35% withholding tax
- Recovery by foreign resident investors
  - Possibility to reclaim withholding tax based on internal law if at least 80% of the fund's income is foreign source
  - Irrespective whether investor is resident in a treaty state or not
- Notification procedure possible (“Affidavit”)
- Are foreign CIVs with Swiss investors "foreign resident investors" in this context?

CIVs with less than 80% foreign source income

- Recovery of Swiss withholding tax on distributions (and accumulated profits) of CIV based on double taxation treaties?
  - No specific rules in OECD-MC
  - Only exemption in Swiss double taxation treaties: Art. 10(4) DTT-Germany (distributions of CIVs fall within the definition of "dividends")
  - Federal Tax Administration: If income of CIV derives predominantly from dividends: dividend article (Art. 10 OECD-MC). If income of CIV derives predominantly from interest: interest article (Art. 11 OECD-MC)

Treaty entitlements: *Switzerland*



Foreign CIVs

- **35% Withholding tax on Swiss investments** (dividends on Swiss shares, interest of Swiss bonds and distributions and accumulated profits of Swiss CIVs)
- **Recovery of Swiss Withholding tax by investors**: Are investors "beneficial owners" of income of CIVs from Swiss investments?
  - **Swiss resident investors in a foreign CIV with Swiss investments**
    - In our view recovery based on internal law (Art. 22(1) Swiss withholding tax act for individuals)
    - Federal Tax Administration denies recovery
  - **Foreign resident investors in a foreign CIV with Swiss investments**
    - In our view recovery based on DTT with state of residence of investor possible
    - This view is in principle shared by Federal Tax Administration

Treaty entitlements: *Italy*

Double tax treaties concluded by Italy

- **Tax treaties concluded by Italy usually do not contain special rules concerning UCITs**

- **Relevant exceptions**:
  - Article 10(6)(b) *DTT Germany*: fund distributions as dividend income
  - Article 24(4) *DTT The Netherlands*: Dutch incentives related to certain funds not taken into account for double taxation relief purposes
  - Protocol VI *DTT Turkey*: Turkey considers fund distributions as dividend income
  - Article 10(9) *DTT USA*: special provisions applicable to RICs (Regulated Investment Companies) and REITs (Real Estate Investment Trusts)

- **Interpretation put forward by the Italian tax authorities**: for treaty purposes fund distributions are considered as Article 11 income (interest)
  - Interpretation rendered with specific regard to distributions by REIFs (Real Estate Investment Funds)
  - DTTs providing for exemption on “interest” income

Treaty entitlements: *Italy*

Foreign UCITS – Applicability of double tax treaties

- **Domestic provisions allowing treaty access to foreign UCITs (art. 10-ter of Law No. 77 dated 23 March 1983, as amended)**

- **Foreign UCITs may benefit from the tax treaties concluded by Italy subject to the following conditions:**
  - they are in compliance with the UCITS Directive and are established in a EU Member State or EEA State included in the Italian white-list, or
  - even if not complying with the UCITS Directive, they are (a) established in a EU Member State or EEA State included in the white-list and (b) subject to regulatory supervision in the State of establishment

- **Furthermore, foreign UCITS may benefit from the tax treaties concluded by Italy <u>with respect to Italian source income</u> provided that:**
  - the state of establishment of the foreign UCITs extends treaty benefits to Italian UCITS on a reciprocal basis and
  - treaty benefits may be granted with respect to income proportionally attributable to the units of the foreign UCITS held by treaty residents.
  - Practical issues

Treaty entitlements: *United States*

U.S. Model

- **The U.S. Model Treaty contains standard definition of resident**:
  - A resident is a person liable to tax by reason of place of management, place of incorporation, or other similar criterion
  - The Model Technical Explanation provides that a RIC meets this definition
  - Although the income earned and distributed is not subject to U.S. tax in the hands of the entity, the income that is not currently distributed is “liable to tax” in the U.S.

Treaty entitlements: *United States*

U.S.-France Treaty

- **A RIC in the U.S. and a SICAV in France are treaty residents**

- **However, treaty benefits are extended to a RIC or a SICAV only if allowed under the LOB provision**

- **A RIC or a SICAV will meet the LOB test if:**
  - More than half the shares, rights, or interests
  - Are owned directly or indirectly
  - By persons that are specified qualified residents of the Contracting State in which the RIC or the SICAV is resident, or in the case of a RIC, by U.S. citizens
  - Provided that all intervening entities in a chain of ownership are resident of that State

Treaty entitlements: *United States*

U.S.-Germany Treaty

- **A RIC in the U.S. and a German Investment Fund and a German *Investmentaktiengesellschaft* to which the provisions of the *Investmentgesetz* apply are treaty residents**
- **However, treaty benefits are extended to a German Investment Fund, or a German *Investmentaktiengesellschaft* only if the LOB provision of the treaty is met**
  - ≥90% the shares or other beneficial interests in the German *Investmentvermögen* must be owned, directly or indirectly, by :
    - Specified qualified residents of Germany or
    - Persons that are equivalent beneficiaries with respect to the income derived by the German *Investmentvermögen*
  - In the case of indirect ownership, only a limited class of indirect beneficial ownership is permitted determined by reference to German law
- **Procedures are to be agreed by the competent authorities in determining whether the** 90%-ownership benchmark is met
  - Statistically valid sampling techniques may be part of the agreed procedures
- **No LOB test is applied to a RIC in order to qualify for treaty benefits in Germany**

Treaty entitlements: *United States*

Other treaties with LOB provisions that allow investment companies to be treaty residents:

- **Estonia**
- **Latvia and**
- **Lithuania**

In these treaties, a RIC is expressly designated as a qualified resident

- **The equivalent entity in the treaty partner state can qualify also, but only if agreed by the competent authorities**

Treaty entitlements: *Hong Kong*

The Tax Treaty Landscape

- **Tax Treaties are generally based on the OECD Model**
- **Key jurisdictions: France, Ireland, Japan, Luxembourg, the PRC, the Netherlands, the UK**
- **Notable omission: the US**
- **Because Hong Kong does not tax income and gains from foreign funds, credit for foreign taxes is rare**

Treaty entitlements: *United Kingdom*

Generally not an issue for UK based funds as treated as companies (other than unauthorised unit trusts) for UK tax purposes and liable to tax

Specific issues:

- **REITs**
- **LOB provisions in US/UK treaty**
- **Tax transparent funds (TTFs)**

Treaty entitlements: *Germany*

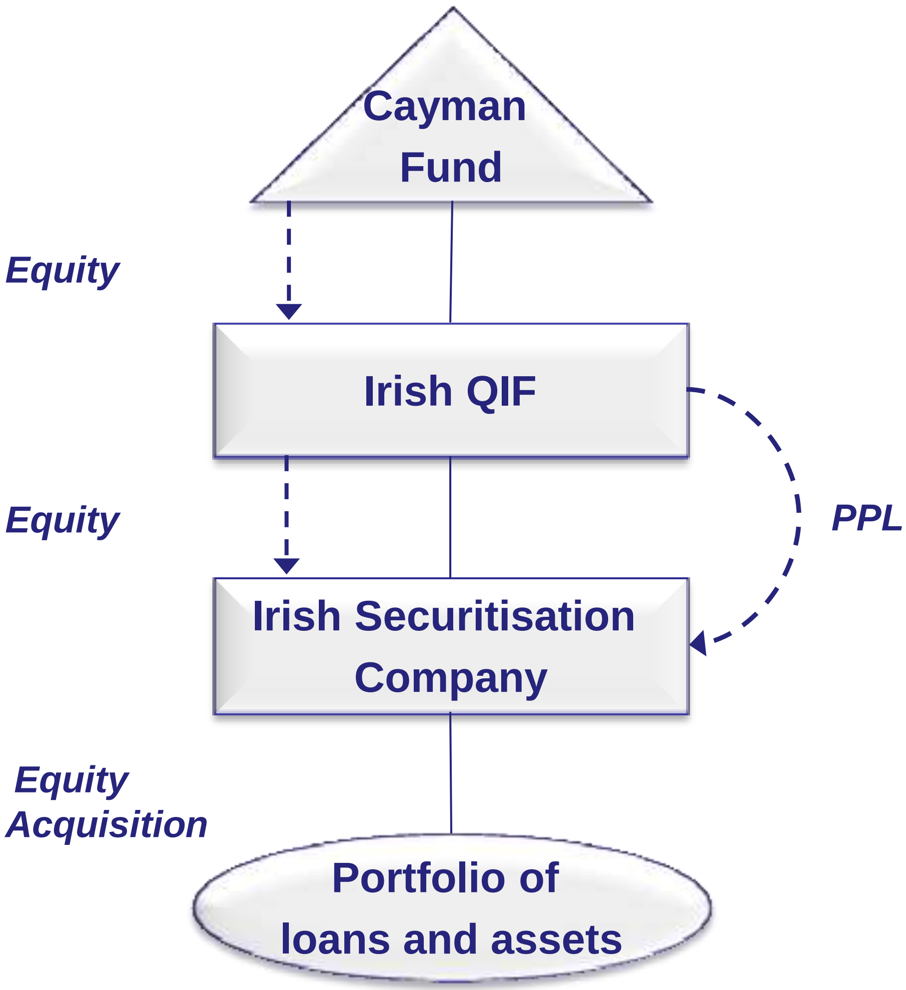
Tax treaties and German regulated funds

- **German perspective: investment funds are eligible for treaty benefits**
  - investment fund is resident as it is a taxable entity (see above)
  - problem: no common OECD approach to tax exempt entities
  - Source country's view?

- **German treaty landscape ➔ treaties with special provisions regarding investment funds**
  - treaty with U.S. (2006)
  - treaty with France
  - treaty with U.K. (2010)
  - revised treaty with Ireland (2011, not yet in force)
  - revised treaty with the Netherlands (2012, not yet in force)
  - revised treaty with Luxembourg (2012, not yet in force)

- **Generally “look-through approach”**
  - eligibility for treaty benefits depends on eligibility of investors and/or
  - investment fund may claim benefits on behalf of its investors

Treaty entitlements: *Ireland*



Irish Securitisation Co

- Irish tax resident
- fully taxable (25%)
- interest on profit participating loan fully tax deductible → nominal profit
- no WHT on interest payments

QIF

- an Irish regulated fund
- income and gains exempt including interest on PPL
- no WHT on distributions to non-residents
- No exit tax for non-Irish resident investors

FATCA

FATCA

Introduction

- On 18 March 2010 the United States enacted provisions commonly referred to as the Foreign Account Tax Compliance Act (FATCA), that introduced reporting requirements for foreign financial institutions with respect to certain accounts. Amongst the other States, Italy is supportive of the underlying goals of FATCA

- On 26 July 2012, Italy, Germany, France, United Kingdom and Spain concluded a model of bilateral agreement aimed at facilitating the applicability of FATCA and at providing adequate exchange of information avoiding additional costs for financial institutions

- The information that financial institutions provide to the tax authorities can be exchanged at state level on an automated basis, according to the agreements against double taxation, in both directions (to and from the U.S.A.) and then under conditions of reciprocity

FATCA: *Overview*

Enacted in 2010 as part of Hiring Incentives to Restore Employment ("HIRE") Act

- **Foreign Financial Institutions ("FFI's") report to I.R.S. information about "financial accounts" held by:**
  - U.S. persons, or
  - Foreign entities in which U.S. persons hold a substantial (≥ 10%) ownership interest

- **Requires FFI's to tell I.R.S. about offshore accounts controlled by U.S. persons if assets exceed $50,000 in value**

FATCA: *Withholding*

FATCA extends the equivalent of domestic "Backup Withholding" to foreign "accounts" held by U.S. persons

- **Unless exception applies, 30% FATCA withholding (new Chapter 4 withholding) *where***:
  - FFI does not have FFI-EIN (i.e., new FATCA ID number), *or*
  - FFI-EIN is wrong (i.e., it does not match with I.R.S. published list)
    - Prop. Reg. §1.1471-3(d)(3)

FATCA: *Participating FFI obligations*

FFI Obligations

- Due Diligence
- Reporting
- Withholding
- Globalization

FATCA: *Participating FFI obligations*

Due Diligence Procedures:

- **Determine what accounts are owned by US persons & US owned foreign entities**
  - Draft Procedures published on February 8, 2012
    - Prop. Reg. §1.1471-4(c)
  - Different procedures depending upon:
    - Pre-existing v. New Accounts
    - Individual v. Entity Accounts

FATCA: *Due diligence (cont)*

Individuals

Preexisting Individual Accounts

- **Accounts ≤ $50,000: No review needed**
- **Accounts > $50,000: Review Electronic records**
  - Look for US indicia (e.g., address, place of birth)
  - If find US indicia, further inquiry required
- **Accounts > $1MM: Review paper records**

New Individual Accounts

- **Person must certify as to status**

Entities

Preexisting Entity Accounts

- **Account ≤ $250,000: No review (until account balance exceeds $1MM)**
- **Accounts > $250,000: Must review**
  - Look at "information maintained for regulatory or customer relationship purposes"
    - AML/KYC Procedures

New Entity Accounts

- **More detailed rules**

FATCA: *FFI Reporting/Withholding*

Reporting to IRS:

- **Report to IRS information about accounts owned by U.S. persons & U.S. owned foreign entities**

- **The emphasis is placed on obtaining information from FFI's and NFFE's**

- **New W-8IMY Form and W-8BEN-E proposed for non-U.S. entities**

FATCA: *FFI Reporting/Withholding*

Payments subject to withholding tax

- **U.S. source FDAP**
- **Sales proceeds from the disposition of securities that produce U.S. source interest and dividends, and**
- **Pass-thru payments**

FATCA: *FFI Reporting/Withholding*

Withholding 30% tax on payment to an investor who is:

- **Non Participating FFI (“NPFFI”)**
  - Investor is itself an FFI and chooses not to participate in FATCA reporting system *or*
- **Recalcitrant holder**
  - Investor in FFI who refuses to give requested information to the FFI is subject to withholding tax on pass-thru payments
  - Pass-thru Payment is a portion of payment to recalcitrant holder that is attributable to deployment of assets in the U.S. – Final definition is reserved at this time
  - Pass-thru payment concept makes NPFFI’s “radioactive” for PFFI’s with U.S. investments

FATCA: *Timetable (updated for Ann. 2012-42)*

January 1, 2013.

- FFI electronic application process expected to begin
- Grandfathered obligations. FATCA withholding not required on obligations outstanding on January 1, 2013 *unless* materially modified after that date

January 1, 2014

- New accounts: Withholding agents (including PFFIs & registered deemed compliant FFIs) must implement "new" account opening procedures
  - USFI's must withhold on U.S.-source FDAP payments to new accounts held by documented NPFFI's and presumed FFI's
  - PFFI's must withhold on U.S. source FDAP payments to undocumented new accounts and new accounts held by NPFFI's
- Preexisting Accounts: Accounts opened prior to January 1, 2014 are categorized as "pre-existing" and account due diligence must generally be completed prior to July 1, 2014 (for prima facie FFI) or by Dec. 31, 2014 (for high value individual accounts) or Dec. 31, 2015 (for other entity or individual accounts)
  - Withholding required after these deadlines

FATCA: *Timetable*

July 1, 2014

- For <u>“preexisting” prima facie FFIs accounts</u>, withholding must be imposed by USFIs & PFFIs *unless* documented that account holder is a PFFI, exempt FFI or not a FFI

January 1, 2015

- For <u>“preexisting” high value individual accounts</u>, withholding must be imposed by PFFIs *unless* documented that they are not US accounts

March 31, 2015

- PFFIs must file information reports for 2013 and 2014 calendar years

January 1, 2016

- For <u>other “preexisting” accounts</u>, withholding must be imposed by USFIs & PFFIs *unless* documented that they are not US accounts
- Expiration of certain phase-in exceptions regarding a PFFI's expanded affiliated group with local law restrictions to compliance must now comply

FATCA: *Timetable*

March 15, 2016

- USFFI's & PFFIs must report 2015 US-sourced FDAP and gross proceeds paid to non-US accounts

January 1, 2017

- USFI's begin withholding on gross proceeds from the sale of property that can produce U.S. source interest or dividends to all documented NPFFI's and presumed FFI's
- PFFI's begin withholding on payments of gross proceeds from the sale of property that can produce U.S.-source interest or dividends to:
  - Preexisting, undocumented high value individual account holders, documented NPFFI's, and prima facie FFI accounts
  - Undocumented new accounts and new accounts held by NPFFI's
- Withholding on foreign pass-thru payments "may" begin

March 31, 2017

- PFFI's must report gross proceeds in addition to all data fields reported previously

FATCA: *Globalization*

February 2012

- Joint Statement from the U.S., France, Germany, Italy, Spain and the U.K. regarding an intergovernmental approach to improving international tax compliance and Implementing FATCA

June 2012

- Joint Statement from the U.S. and Switzerland regarding implementation of FATCA
- Joint Statement from the U.S. and Japan regarding implementation of FATCA

July 2012

- Joint Communiqué by France, Germany, Italy, Spain, the U.K. ,and the U.S. regarding the publication of the Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA

September 2012

- 1st IGA to be signed: US-UK IGA

FATCA: *Two versions of the Model Agreement*

Reciprocal and Nonreciprocal Forms

- **Establish a framework for reporting by FFI's of certain financial account information to their respective tax authorities**
- **Automatic exchange of information under existing bilateral tax treaties or tax information exchange agreements**
- **Addresses the legal issues that had been raised in connection with FATCA and simplifies implementation for financial institutions**

FATCA: *Reciprocal Model Agreement*

Reciprocal Form

- **U.S. and partner country (“FATCA Partner”) exchange information relating to the *other* country's residents owning accounts with an FI in the reporting country**
  - The exchange is made on an automatic basis (See Article 2)
  - Used by U.K., Germany, France, Italy and Spain, who agreed to this approach on February 8
    - Other countries to follow
    - Applies only to jurisdictions with which the U.S. has an income tax treaty or tax information exchange agreement
  - Reporting is required even if the account produces only income that arises from sources outside the U.S.

FATCA: *Reciprocal Model Agreement*

Reporting requirements <u>from</u> FATCA Partner to I.R.S.:

- Name, address, and U.S. TIN of each Specified U.S. Person that is an Account Holder
- Account number
- Name and identifying number of the Reporting Financial Institution
- Account balance or value as of end of relevant calendar year

U.S Reporting requirements <u>to</u> FATCA Partner:

- Name, address, and TIN of any person that is resident of FATCA Partner jurisdiction and is an Account Holder
- Account number
- Name & identifying number of Reporting U.S. Financial Institution
- Gross amount of U.S. source interest, dividends or other income paid or credited to the account

FATCA: *Reciprocal Model Agreement*

When must this information be given to the other country? Art. 3(5)

- **For reporting year 2013 information, not later than Sept. 30, 2015**
  - 1 year later than provided in the regulations
- **For information beginning from reporting year 2014, not later than 9 months of end of year**

FATCA: *Due diligence*

How does the FFI determine what accounts are owned by US persons or US owned foreign entity?

- **Annex I to each Model Agreement contains 15 pages of procedures to follow to identify US reportable accounts**
  - Follows the approach of the Proposed FATCA Regulations published in February

FATCA: *Additional Points*

FATCA Partner FFI

- **Need not withhold or close accounts of recalcitrant holders as long as U.S. gets information about holder (Art. 4(2))**
  - However, the closing of accounts held directly or indirectly by U.S. persons is common
- **If FFI does not "significantly comply," the U.S. notifies FATCA Partner (Art. 5(2))**
  - FATCA Partner contacts FFI to resolve problem
  - If problem not resolved within 18 months, FFI is categorized as a non-participating that becomes subject to FATCA withholding

FATCA: *Non-reciprocal Model Agreement*

Non-Reciprocal

- **Only FATCA Partner is obligated to supply information with respect to U.S. Reportable Accounts to the I.R.S. (See Article 2)**
  - Same reporting requirements imposed on the Foreign FATCA Partner
  - Participating Countries: To be announced

FATCA: *A tour d'horizon*

Model I IGA Agreements

Reciprocal Agreement	**Two-way Street** ▪U.S. & FATCA Partner country exchange information relating to *<u>other</u>* country's residents owning accounts with an FI in reporting country
Non-Reciprocal Agreement	**One-way Street** ▪Only FATCA Partner country is obligated to supply information with respect to US Reportable Accounts to IRS

FATCA: *A tour d'horizon*

Model II IGA Agreements

- **Treasury also announced a 3rd form of IGA for Japan and Switzerland, which they called Model II**
  - Non-reciprocal form of Agreement so only information is supplied to IRS
    - BUT FFI reports information directly to IRS and not to tax authorities in Japan or Switzerland
  - No form for this Agreement has yet been released

OTHER TAX ISSUES

Other fund taxation issues

Withholding tax – Santander Case

- **ECJ Judgement of 10 May 2012**
- **French WHT imposed on dividends to foreign UCITs**
- **Absence of WHT to French UCITs unconditional**
- **Held to be discriminatory**
- **No other justification**
- ***NB* - the pension fund cases - (Commission v Portugal C493/09)**

Other fund taxation issues

Withholding tax – Santander Case: *the Italian view*

- **Dividend distribution from an Italian company to an Italian investment fund is tax exempt**
- **The same distribution to a foreign investment fund is subject to a 20% withholding tax**
  - The regime previously in force provided for a 27% withholding tax
- **Discrimination of foreign investment funds under the EU Treaty**
  - Freedom of capital – applicability to non-EU investors
- **ECJ C-338/2011 – *Santander***
- **Refund procedure**

Other fund taxation issues

Fund investment managers taxation issues in an international context: *Ireland & the United Kingdom*

- **Investment management exemption**
- **Removes the charge of tax on profits/gains of the foreign fund from a financial trade exercised in Ireland and the United Kingdom through an authorised agent**
- **U.K. Conditions:**
  - Independence/ 20 per cent test
  - Subject matter investments
  - Customary remuneration
- **Irish conditions:**
  - Agent is an “authorised agent”
  - Trade is a “financial trade”
  - Agent is independent of the foreign fund

Q & A

WRAP-UP