BEPS – latest developments for investment managers

- Event Date: Tuesday 24 March, 2015
- Event Time: 9:00 am – 10:00 am (Eastern)
  2:00 pm – 3:00 pm CET
Agenda

1. Where are we on BEPS – latest developments for investment managers
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4. Managing communications with the tax authorities
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BEPS Roadmap

1. Digital Economy
   - Report on challenges complete; VAT discussion draft Dec 2014, final report Dec 2015

2. Hybrid Mismatches
   - Recommendations complete; guidance expected Sep 2015

3. CFCs
   - Discussion draft April 2015; finalised Sep 2015

4. Interest deductions
   - Discussion draft Dec 2014; best practices due Sep 2015, OECD guidelines in Dec 2015

5. Harmful tax practices
   - Initial report complete; strategy for non-OECD members Sep 15 final criteria Dec 2015

6. Treaty abuse
   - Finished - draft on Collective Investment Vehicles Nov 2014, finalised Sep 2015

7. Definition of PE
   - Further discussion draft Oct 2014, consultation Jan 2015, finalised Sep 2015

8. TP - Intangibles
   - Consolidated
     - Intangibles: Paper 1 finished; discussion draft on special measures Apr 2015
     - Low-value adding services - discussion draft Oct 2014

9. TP - Risk & Capital
   - Risk, recharacterisation, commodity transactions, profit splits - discussion drafts Dec 2014
   - Consultation in March 2015. All work finalised by Sep 2014

10. TP - High Risk
    - Request for input Aug 2014, discussion draft Jan 2015, finalised in Sep 2015

11. BEPS data
    - Public consultation May 2015, finalised in Sep 2015

12. Mandatory Disclosure
    - Final except for implementation mechanism (due Feb 2015)

13. TP - Documentation
    - Discussion draft Dec 2014, finalised in Sep 2015

14. Dispute Resolution
    - Feasibility report complete; draft mandate in Jan 2015 with international conference due Dec 2015

15. Multilateral Instrument
    - Feasibility report complete; draft mandate in Jan 2015 with international conference due Dec 2015

2014

2015

We are here

KPMG International, 2015
Key messages - what is changing?

Global view of value chain

- Capital Introduction
- Marketing and Distribution
- Investor Relations
- Investment Management
- Risk Management
- Regulation and Compliance
- Operations/Middle and Back Office
- CbCR
- Interest deductibility
- Treaty abuse
- TP documentation
- Hybrids
- PE definition
- Risks and Capital
BEPS Action Items most relevant to IM, AI, and P-E

All of the BEPS Actions have the potential to affect IM, AI, and P-E, but the following Actions are most likely to have a significant impact:

- **Action Item 2 – Hybrid Mismatches**: Will definition and changes related to hybrids affect how investments are structured and the efficiency of cash repatriation to funds?

- **Action Item 4 – Interest Deductions**: What additional requirements will be implemented? Interaction with changes to hybrids?

- **Action Item 6 – Treaty Benefits**: Changes to treaty abuse provisions may result in changes to the structuring of funds and holding companies.

- **Action Item 7 – Permanent Establishments (PE)**: A wider definition of permanent establishments could affect IM, AI, and P-E models. Permanent Establishment focus not just on dependent agent, but also broader consideration of operational presence.
BEPS Action Items most relevant to IM, AI, and P-E

- **Action Items 8 and 9 – Intangibles and Risk & Capital**

- **Action Item 13 – Transfer Pricing Documentation:**
  - CbyC reporting, Master File and Country File documentation
Actions 8 -10

Risk, Re-characterizations, Special Measures & Profit Splits
Key points:

- A major rewrite of Chapter 1
- Risks should be analysed with specificity
- At arm’s length risk is most likely to be assumed by parties that manage or control it
- Re-characterisation is becoming non-recognition
## Risk and Re-characterization – example

<table>
<thead>
<tr>
<th>Investment Manager</th>
<th>Payment of advisory/marketing fee</th>
<th>Investment Advisor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Provision of advisory services</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Holder of mandates with the managed funds</th>
<th>Research services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Making the final investment decisions or recommendations</td>
<td>Marketing and distribution</td>
</tr>
<tr>
<td></td>
<td>Making investment recommendations</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Residual management fee income after paying the advisory/marketing fee</th>
<th>Remuneration</th>
<th>Cost plus</th>
</tr>
</thead>
</table>

- Regarding specificity, ability to:
  - Monitor;
  - Assess; and
  - Direct the mitigation of risk.

- If the asset or mandate holder does not have the capability to control the risks associated with exploitation of the asset, the proposed changes suggest that its return should be limited to a return on financing the cost of the asset.

- In an IM context, this return could be very small/negligible.

- Therefore, full fee allocated to investment advisor.
Introduction to Special Measures

Key points:

- Designed to deliver action plan commitment with regard to intangibles, risk and over capitalisation

- Option 1: Hard to Value Intangibles

- Options 2 and 3: To deal with over capitalisation

- Option 4: Minimal Functional Entity – seeks to align profits with value creation

- Option 5: A CFC solution
Special Measures – example

Inappropriate returns to capital

- The draft includes an example of an independent investor
- Given the choice, where would they choose to invest?:
  - The entity with the capital?
  - The entity with the ability to manage the risk associated with the capital?
- The draft suggests at arm’s length, the rational investor would invest in the entity with the ability to manage the risk
- Appears to contradict the fund management industry!

Minimal functional entity

- Does the investment manager lack the substance to effectively manage the mandate.
### Special Measures – Example

#### Investment Manager
- **Holder of mandates with the managed funds**
- **Making the final investment decisions or recommendations**

#### Functions
- **Research services**
- **Marketing and distribution**
- **Making investment recommendations**

#### Investment Advisor
- **Payment of advisory/marketing fee**
- **Provision of advisory services**

#### Minimal functional entity
- Qualitative and quantitative test for substance of IM
- **Does the IM:**
  - Lack the substance to exploit the mandate with the funds?
  - Value of asset is greater than a thick capitalization ratio
- **May lead to:**
  - A mandatory profit split
  - Reallocated income to the IA or another entity that has the functional substance

#### Remuneration
- **Residual management fee income after paying the advisory/marketing fee**
- **Cost plus**
Introduction to Profit Splits

Key points:

- Increased recognition of the importance of global value chains and multisided business models
- Unique and valuable contributions
- Integration and sharing of risk
- Lack of comparables and one sided methodologies
- Practical aspects of implementing a profit split
### Profit Splits – example

<table>
<thead>
<tr>
<th>Investment Manager</th>
<th>Distributor</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Payment of distribution fee (% of man/perf fees)</strong></td>
<td><strong>Provision of marketing and distribution services</strong></td>
</tr>
</tbody>
</table>

**Functions**
- Holder of mandates with the managed funds
- Performing investment management

**Marketing and distribution related to managed funds**

**Percentage of management and performance fees**

**Remuneration**
- Percentage of management and performance fees

**Profitability**
- Marketing Fee
- Op Ex
- Profit
- Margin

<table>
<thead>
<tr>
<th>Turnover</th>
<th>100</th>
<th>30</th>
<th>20</th>
<th>20%</th>
</tr>
</thead>
</table>

- **100** (50)
- **30** (30)
- **20** 20%

**Profitability**

- Marketing Fee
- Op Ex
- Profit
- Margin

<table>
<thead>
<tr>
<th>30</th>
<th>15</th>
<th>50%</th>
</tr>
</thead>
</table>

- **30** (15)
- **15**
- **50%**

### Challenges:
- Are both parties making ‘unique and valuable contributions’?
- How comparable are the CUPs?
- Isn’t the success of the distribution function partly dependent on the track record generated by the IM function?

- May lead to a profit split being more appropriate, or used to corroborate single sided approach

- The example shows a typical investment management transfer pricing structure using CUP data to support a 30% distribution fee

- A consequence of the structure is that the distributor makes a 50% margin whilst the IM makes a 20% margin
Action 13
Country by Country Reporting
### A reminder of the final template published on 16th September 2014 – Page 1

<table>
<thead>
<tr>
<th>Tax Jurisdiction</th>
<th>Unrelated Party</th>
<th>Related Party</th>
<th>Total</th>
<th>Profit (loss) before income tax</th>
<th>Income tax paid (on a cash basis)</th>
<th>Income tax accrued – current year</th>
<th>Stated Capital</th>
<th>Accumulated Earnings</th>
<th>Number of employees</th>
<th>Tangible Assets other than Cash and Cash Equivalents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country A</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Country B</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Not resident in any tax jurisdiction</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Tax Jurisdiction</th>
<th>Constituent entities resident in the tax jurisdiction</th>
<th>Tax jurisdiction of organization or incorporation if different from tax jurisdiction of residence</th>
<th>Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country A</td>
<td>Entity A</td>
<td>Country B</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Entity B</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Country B</td>
<td>Entity C</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Entity D</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>PE 1</td>
<td></td>
<td>✓</td>
</tr>
</tbody>
</table>
Implementation guidance

- The **ultimate parent** of the MNE group will be required to file the CbyC Report in their jurisdiction of residence.

- The first period in scope will be the MNE’s fiscal year beginning on or after **1 January 2016**.

- Filing will be within **12 months**, so first filings will be 31 December 2017.

- A report will be required each year but there will be an exemption for MNE groups with **annual consolidated group revenue** in the immediately preceding fiscal year of less than €750m.

- There will be **no other exemptions** from reporting and no general exemption for investment funds.

- Filing should be with the **parent country tax authority**.
Which groups are caught?

Are you a reporting multinational enterprise (MNE)?

Key considerations
- No definition of “MNE” in Action 13 guidance
- Consider PEs / Branches
- Expanding group / acquisitions
- Different types of business structure
- Ultimate parent of an MNE group

Is the consolidated group revenue in the immediately preceding fiscal year less than €750 million?

Key considerations
- Revenue definition = third party revenue, plus other third party income within the definition for CbyC (e.g. royalties, interest, unrealised gains)
- Currency
- Fluctuating revenue
- No consolidated group accounts
Scope of entities to be reported

- **Reporting MNE**
  - “Ultimate Parent Entity of an MNE group”
  - An entity which is not controlled by any other entity
  - Usually where group consolidated accounts produced
  - Complex for funds

- **Constituent Entity (CE)**
  - Any entity “included in the consolidated group for financial reporting purposes”
  - Broadly this should be fully consolidated entities
  - Entity is all types of vehicle, so partnerships, branches, trusts etc.

- **PE / Branch**
  - Include data in the country of operation
  - Except accumulated earnings and stated capital (unless regulatory requirement to hold capital)
  - Representative offices?
Example structure 1 – Investment Manager perspective

- Investment Manager Global Hold Co
  - US
  - Investment Manager UK
  - Investment Manager Luxembourg
  - Fund A Cayman
  - Majority interest held in managed fund
  - Investment Manager Ireland
  - Fund B Ireland
  - Majority interest held in managed fund
Example Structure 2 – Fund perspective

LP Cayman

Corporate QIF Ireland

QIF used for non US investors

Cayman LP used for US taxable investors

LP Cayman

Fund holds majority investments in operating and trading companies

Operating Company UK

Operating Company France

Operating Company German

KPMG International, 2015
Example Structure 3 – Investor perspective

- Pension Fund Canada
  - SICAV Luxembourg
    - Operating Company UK
    - Operating Company France
    - Operating Company Germany

Pension Fund holds majority interest in Lux PE fund

Fund holds majority investments in operating and trading companies
Countries have agreed to conditions underpinning the obtaining and use of the report. These include the requirement for countries to have protections in place for the confidentiality of the report at least equivalent to those available under:

- The Multilateral Convention on Mutual Administration Assistance in Tax Matters, or

- Tax Information Exchange Agreements, or

- Tax Treaties meeting the standards of the Global Forum on Transparency and Exchange of Information for Tax Purposes

Confidentiality

Consistency

Appropriate use
Filing and sharing mechanism

- The CbyC report should be filed with the **parent** tax authority.
- The parent tax authority should **automatically share** it with other tax authorities, meeting the conditions.

The OECD **encourages** as many countries as possible to expand their **coverage of international agreements** for exchange of information to allow this to happen.

The mechanism works if:
- The ultimate parent entity is located in a country that has **implemented** CbyC reporting; and
- That country has a **sharing mechanism** in place, and has signed up to the three **conditions** set out previously.
Secondary mechanism

The clear intention of the OECD is to develop an automatic exchange of information mechanism that will give participating governments wide access to CbyC information. However, the OECD is also going to consider what secondary mechanisms might be required to support this primary method.

Where a jurisdiction fails to provide CbyC Reports for MNE groups headquartered in their jurisdiction, to another jurisdiction, because:

- It has not required CbyC reporting through domestic legislation; or
- No competent authority agreement has been agreed in a timely manner for the exchange of the CbyC reports; or
- There is a failure to exchange the information in practice.

A secondary mechanism would be accepted as appropriate, through either:

- The receiving jurisdiction requiring a local filing; or
- By moving the obligation for the filing of the CbyC Report to the next tier parent country.
Secondary Mechanism

Hold Co. Country A

Subsidiary Country B
Subsidiary Country C

Subsidiary Country D
Subsidiary Country E
Subsidiary Country F
Subsidiary Country G

OR individual jurisdictions oblige the subsidiary to file locally

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The first CbyC reports would be filed for Multinational Enterprises (MNEs) fiscal years beginning on or after 1 January 2016.

Filing is due 12 months from the end of a financial year. E.g., a company with 31 December 2016 year end will be due to file the CbyC report by 31 December 2017.
How are groups preparing?

- Setting up the steering group
- Scoping and interpreting/applying the guidance
- Understanding data sources
- Performing a dry run and assessing the results
Managing communications with the tax authorities
Managing communications with the tax authorities

The potential issue

- Tax authorities will have unprecedented information regarding allocations of profit
- Only Table 3 in the CbyCR template gives the opportunity to explain the split
- Tax authorities may respond differently to this information
- How best to manage?
Managing communications with the tax authorities

The proposed strategy

- Many tax authorities welcome a ‘collaborative relationship’ with tax payers

- Opening dialogue early allows the explanation of value chain and TP policies

- Combine with discussions to manage notifications to tax authorities where they may be required as part of local anti-avoidance measures?

- May be worth considering compiling Master File now, as many of the considerations to be discussed would be included
## MasterFile and Country File documentation

### Master File

<table>
<thead>
<tr>
<th>High Level overview (group-wide or line of business basis) – and descriptions of:</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ The <strong>businesses</strong> including <strong>drivers of business profit</strong>, <strong>charts on supply chain</strong> (for five largest and/or 5% of turnover); a list of intra-group services; functional analysis; any business restructurings</td>
</tr>
<tr>
<td>▪ <strong>Intangibles</strong> including the <strong>group’s strategy for the development of intangibles</strong>, a list of material intangibles, a list of agreements relating to intangibles, any <strong>transfers of intangibles</strong> and TP policies related to R&amp;D and intangibles</td>
</tr>
<tr>
<td>▪ <strong>Intercompany financial activity</strong> including how group is financed, identification of treasury companies, and TP policies relating to financing</td>
</tr>
<tr>
<td>▪ <strong>Financial and tax positions</strong> including unilateral APAs, and other tax rulings relating to the allocation of income</td>
</tr>
</tbody>
</table>

### For each jurisdiction

<table>
<thead>
<tr>
<th>Description of the <strong>management structure</strong>, organizational chart, restructurings, key competitors</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ <strong>Description</strong> of the <strong>controlled transactions</strong>,</td>
</tr>
<tr>
<td>▪ For each category of controlled transactions,</td>
</tr>
<tr>
<td>▪ description of material controlled transactions and list of associated enterprises</td>
</tr>
<tr>
<td>▪ <strong>copies of material intercompany agreements</strong></td>
</tr>
<tr>
<td>▪ <strong>intercompany payments for each category by jurisdiction of counter-party</strong></td>
</tr>
<tr>
<td>▪ detailed functional analysis including any changes to prior years (can be cross-referenced to Master File)</td>
</tr>
<tr>
<td>▪ most appropriate TP method &amp; tested party</td>
</tr>
<tr>
<td>▪ list of comparables and assumptions made</td>
</tr>
<tr>
<td>▪ reasons for concluding transaction was conducted on arm’s length basis</td>
</tr>
<tr>
<td>▪ a summary of the financial information used in applying the TP methodology</td>
</tr>
<tr>
<td>▪ <strong>a copy of existing APAs and other tax rulings which are related to the controlled transactions</strong></td>
</tr>
<tr>
<td>▪ <strong>Financial information</strong> for local entities, including local financial accounts and <strong>linkages between info used for TP and financial statements</strong>.</td>
</tr>
</tbody>
</table>
Q&A
Thank you ....

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