Keeping up with Tax Banking and Capital Markets

December 2021

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Introduction

We are pleased to share with you the December edition of our publication, “Keeping up with Tax: Banking and Capital Markets” which includes our insights on a range of operational and current topics relevant to our industry.

Specifically the articles cover the following areas:

- Operational transfer pricing: Beyond transfer pricing policy and strategy, building sustainable transfer pricing implementation
- Digital transformation and upskilling in the banking sector - Building for success
- FATCA: Notification from the Luxembourg Tax Authorities in case of missing US TIN in the context of the FATCA/CRS compliance program
- VAT Case Law update - Danske Bank
- New guidance from the EUCJ on the scope of the fund management VAT exemption

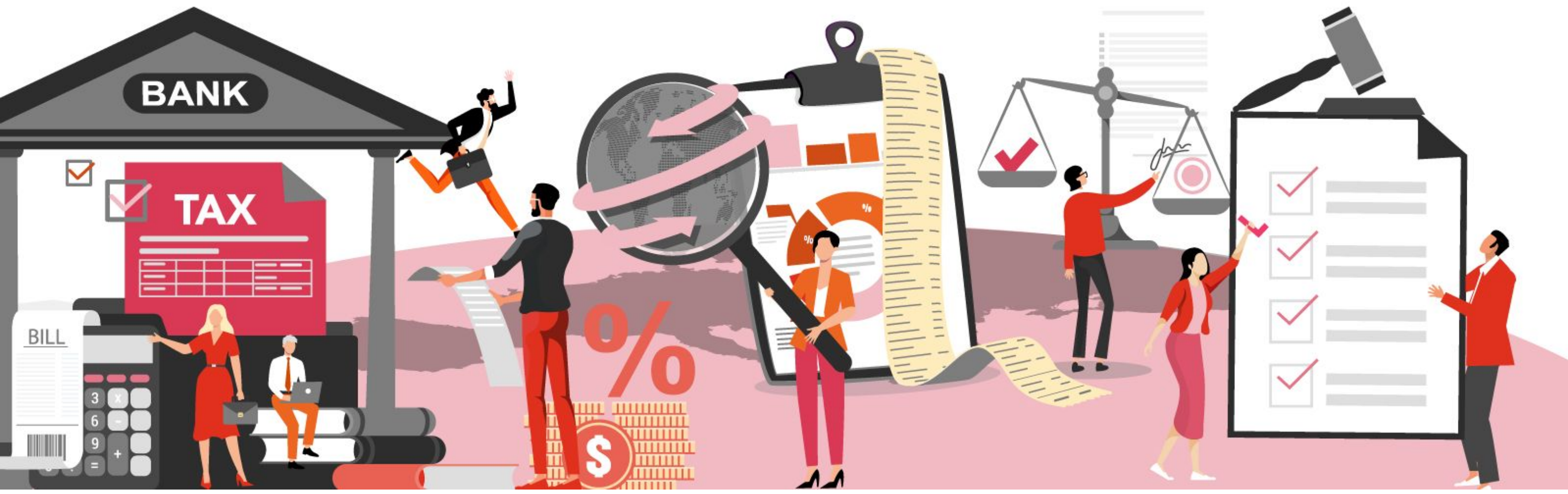
We hope you find the content useful and would welcome your feedback and suggestions for topics you would like us to cover in future editions.

You will also be able to read our various articles via our Linkedin posts that we will share with our respective community.

Our next edition will be issued in mid Q1 of next year and we take this opportunity to already wish you and your family a Merry Christmas and a Happy New Year.

Kind regards,

Roxane Haas & Murielle Filipucci



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Operational transfer pricing: Beyond transfer pricing policy and strategy, building sustainable transfer pricing implementation

In brief

In the current climate, transfer pricing implementation requires more attention than ever to reduce the risk of errors in tax compliance, tax leakage and disputes. This is no longer solely an issue for finance and tax teams but touches a large number of internal and external stakeholders; from the CFO to non-executive Directors and other business departments, tax authorities, statutory auditors and internal auditors. In particular, the tax authorities' focus on transfer pricing (and profit diversion more generally) has intensified, making headlines in newspapers over the past few months, including the recent Financial Times article announcing that HMRC has 'multiple live criminal investigations involving transfer pricing disputes'. But also in Luxembourg the number of pricing audits have significantly increased since last September.

This change in landscape means that taxpayers need to consider the implications for their transfer pricing policy, strategy and operational implementation.

In detail

Why are operational taxes important now?

In response to increasing external and internal pressure, we are seeing clients focus resources on ensuring their transfer pricing processes/governance, and their transfer pricing implementation framework, provide the necessary transparency, data quality and visibility that enable fact-based decision-making and underpin better transfer pricing risk management.
We now look to explore a number of key topics in more detail including: (i) the transfer pricing lifecycle and operational transfer pricing triggers; and (ii) how governance and implementation processes can be improved to satisfy the requirements of all the stakeholders involved.

The transfer pricing lifecycle and operational transfer pricing implementation

Transfer pricing implementation is at the core of the transfer pricing lifecycle. Whilst transfer pricing strategy, policy and documentation are critical, experience shows that failures in execution substantially increases transfer pricing risks. Tax authorities around the globe are becoming more focused on accuracy, transparency and quality of the data used in the transfer pricing calculations, as well as the underlying process and governance followed. In the UK, this has come into sharp focus both through recent HMRC enquiries and through profit diversion compliance facility ("PDCF") cases.

Globally, regulators also look at transfer prices in cross-border transactions, with an increasing focus on the robustness of the transfer pricing implementation governance and underlying processes and cash flows.

Experience in the banking and capital markets sector shows that inadequacies in the transfer pricing implementation often materialise in a lack of transparency in the cost allocations processes (e.g. central cost base and cost centres to be recharged), over reliance on advance pricing agreements ("APA") (e.g. too much comfort is taken from the existence of the APA but whilst the policy is agreed, correct implementation remains important) and in difficulties for segmentation and profitability monitoring (e.g. legal entity, line of business or product level). Operational transfer pricing failures can have material impacts on the financials and as a result potentially impact the firm's regulatory capital position.

Some of the common pain points include:

• misalignment between the documented transfer pricing policy and the implementation of these policies as result of systems failing, human error, or a disconnect between responsible departments;

• lack of clarity in roles and responsibilities for managing the end to end transfer pricing process between the tax, finance and operations functions;

• volume and complexity of financial systems with numerous 'bolt-ons' to in-house systems that have not been developed to be scalable and deal with growth or complexity;

• challenges on accuracy of data received from finance functions in relation to budget and forecast (e.g. when pricing intra-group service transactions or cost recharges);

• complexities and inconsistencies in defining inputs and treatment of routine contributions in the context of global profit split models;

• difficulties in retrieving historical data for local audits (often because data transparency and visibility are opaque);

• difficulties in reconciling data (especially where cost allocations are run regularly - for example, monthly or quarterly); and

• reliance on key individuals or complex spreadsheets running manual processes.

Many banking groups have recently experienced business model changes as a result of Brexit. It is our experience that increased pressure is often placed on pre-existing implementation issues or that new issues arise as business models evolve. It is also our experience that many, if not all, of these challenges can be successfully addressed through a combination of improvement and optimisation on the people/governance, processes, technology and control aspects of the transfer pricing lifecycle. In particular during transfer pricing audits in Luxembourg, we experience that the tax authorities are keen on verifying the alignments of the transfer pricing documentation with the tax returns, accounts and intercompany agreements.

What can you do to improve your transfer pricing implementation?

To mitigate the risks inherent in transfer pricing implementation and to satisfy the requirements from the various stakeholders, organisations should seek to build a comprehensive end-to-end framework supporting the implementation of transfer pricing policies, which in some cases may involve wholesale re-work of their transfer pricing systems. We have seen a number of banking organisations engage in large scale finance change programmes recently and this is an opportune time to ensure transfer pricing implementation requirements are communicated, understood and captured. For others, there is an opportunity to significantly improve existing approaches through smaller refinements, additions or upgrades. In either case, components we have seen clients benefit from focusing on include:

• introducing or improving a holistic governance framework involving all key stakeholders and contributors;
• designing and optimising transfer pricing processes and workflows collaboratively across tax, finance, IT and other business areas to develop a coherent framework which also provides clarity on roles and responsibilities across the different teams;

• clearly understanding the data and system requirements along with any potential data and / or system restraints;

• standardising transfer pricing processes, by building business process documentation, with the aim of creating an overall robust control environment;

• identifying opportunities for automation by implementing transfer pricing engines and analytical tools that enable the automation of data extraction, transfer pricing calculations, intragroup invoicing and so on;

• ensuring adequate training is provided to new and existing contributors to the process; and

• capturing and reporting of key risk indicators and the effective operation of key processes and controls

Based on our experience, we are seeing a number of benefits for those groups engaged in the journey of optimising their internal end to end transfer pricing governance and implementation processes. These benefits include, among others: better management of transfer pricing related risks, increased readiness for tax authority scrutiny and potentially disputes, internal cost savings - driven by more efficient internal processes - and enabling data-driven decision making. In practice, we see currently most benefit on the governance to ease discussions with the Luxembourg tax authorities.

Takeaway

Understanding and managing transfer pricing implementation is not new for the banking sector, but it is increasing in importance. This is driven by tax authority activity, regulatory scrutiny as well as the broader commercial environment. Together, these are giving many firms the stimulus to think through how transfer pricing implementation can be improved and controlled. To succeed in managing the operational transfer pricing aspects, best practice recommendations are to ensure that:

1. operational transfer pricing pain points are identified both within and outside of tax;

2. roles and responsibilities in the end to end process are clearly articulated and agreed by all parties;

3. you develop a coherent response to the various operational transfer pricing pain points, combining people/governance, processes, technology and controls; and

4. comprehensive end-to-end frameworks are built by designing, optimising and standardising transfer pricing processes, as well as identifying opportunities for automation - whether that is large-scale or tactical.

Banking and capital markets organisations have been most successful in upping their game on transfer pricing implementation where the business case for change is well articulated, clearly understood and has buy-in from senior stakeholders. That typically means tax and wider finance teams being prepared to map out their current processes around transfer pricing execution and understand the pain points and risks as well as the quick wins that operational transfer pricing will bring to the organisation.

The road to operational transfer pricing improvement may not always be straightforward, but with a clear understanding of where you are starting from, a vision of where you are heading, and a decent map of the organisational environment, the journey for all stakeholders - internal or external - will be smoother, thereby improving the ability to meet everyone's expectations along the way.

For a discussion on how to tackle operational transfer pricing in your organisation, please get in touch with the authors of this article or your normal PwC contact.

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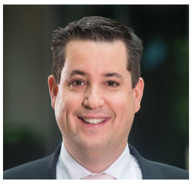

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Digital transformation and upskilling in the banking sector - Building for success

In brief

The banking sector has faced massive disruption in recent years, with the emergence of challenger banks and regulatory changes designed to increase competition. Our Annual Global CEO Survey shows that challenges remain and COVID-19 has introduced further disruption. Digital agility and a highly skilled workforce are two key tools to best mitigate against current disruption and prepare for further disruption to come.

In detail

Traditional banking models need to transform. They must evolve to cater to the changing expectations of customers and to keep pace with growing competition from digital disruptors.

Today, many of those previous barriers to entry have disappeared, enabled by the cloud and other digital technologies, as well as by changes in the regulatory landscape aimed at encouraging innovation and delivering more choice for banking customers.

While technology is critical to transformation, it's not the whole story. Successful transformation also requires banks to change their cultures, mindsets and skills, whilst keeping customer wants and needs at the heart of everything they do.

The results of PwC's **23rd Annual Global CEO Survey** suggest the industry has yet to solve this challenge, but it must. In a fast-changing economy, winning companies are adept at building new skills and capabilities, particularly those based on digital technology. These organisations have moved beyond the traditional ideas that upskilling equals training and that the workforce is a fixed entity, and instead, they create more flexible ways to access the skills and capabilities they need. Although those skills can be gained through alliances, joint ventures, partnerships with government and academia, and other types of collaborations, the most lasting results come from upskilling the current base of full-time employees.

The COVID-19 pandemic has only underscored the need for digital transformation and upskilling initiatives aimed at improving both internal processes and customer engagement. Consider the changing roles of commercial bankers, wealth advisors, and insurance sales and distribution staff, all of whom are now engaging with clients via digital channels for sales, relationship-building and support. Or consider the way that the shift to working from home increases pressure on organisations to manage security as well as employee productivity, with impacts on a company's real estate portfolio and IT infrastructure.

With so much time and money at stake, demonstrating a strong financial return is essential — buy-in from the leadership and engagement within the workforce will quickly evaporate if the effort shows no clear evidence of benefits. In a well-planned digital upskilling initiative, financial growth follows from efforts to build talent and improve the external stakeholder experience, so it's important to track key metrics in all those areas.

Building a successful upskilling strategy calls for management to focus on six aspects:

Focus on digital tools and new ways of working.

Every organisation needs to set out its own priorities, but we believe that digital tools and new ways of working should be on the agenda for just about all financial services organisations. For example, many institutions now find themselves building and maintaining client relationships virtually, through digital channels. Longer-term, product teams will still likely need to work remotely to assemble cross-functional teams to collaborate on product development. The creativity and innovation needed for success require both new technology and new ways of working—which in turn call for upskilling initiatives.

Tell a powerful story about the value of upskilling.

Make a case for upskilling, outlining the strategy and the road ahead, and amplifying the message through regular communications in various channels. Company leaders and 'digital champions' in the workforce need to reinforce these messages over time, to ensure the organisation is aligned around the plan.

Pilot within a segment of the workforce.

Rather than launching company-wide initiatives, identify a narrower base for early-stage measures.

This could be the leadership team; a business unit, function or region with a particularly urgent need; or a set of key influencers.

Integrate the upskilling initiative with existing talent and training programmes.

Upskilling can't exist in a vacuum. It needs to be linked to processes such as performance management, recognition and rewards and other elements of HR already in place. This kind of alignment will further reinforce the company's commitment and help boost employee participation.

Prepare for obstacles

Anticipate common concerns, especially employee anxiety. A key message to convey is that upskilling programmes are truly an investment in employees as individuals, designed to improve both company and personal performance. Find productivity improvements that will allow employees to do much of the training during work hours. Moreover, organisations should seek to reskill any staff that will be affected by restructurings or headcount reductions, to create future employment opportunities for them. This is an important component of banks living their purpose and standing up for their people, even as the industry becomes more competitive.

Ensure longevity

Make sure upskilling isn't viewed as just another corporate fad. Generating sustainable progress requires that you identify KPIs, measure progress and refine the company's approach over time. However, the use of technology to boost productivity can have a downside in terms of burning people out. Organisations need to strike the right balance between productivity and employee well-being. The right approach to upskilling optimises both.

Address the company permanent establishment risk

From a corporate tax perspective, the presence of employees/managers of a Luxembourg company in another country may lead to the recognition of a permanent establishment in that other territory.

If Covid-19 and digitalisation have sped up the transition to home-based working and remote workers, companies should not neglect the risk of creating a fixed place of business. As a basic principle, the higher the person working abroad is in the internal management hierarchy, the higher the risk of creating a permanent establishment abroad. This is only a basic principle, there are much more indicia leading to a permanent establishment and a case-by-case analysis is required knowing a.o. that foreign tax authorities may have different requirements.

Takeaway

The establishment of successful upskilling strategy requires the management to focus on the six aspects:
1. Focus on digital tools and new ways of working.
2. Tell a powerful story about the value of upskilling.
3. Pilot within a segment of the workforce
4. Integrate the upskilling initiative with existing talent and training programmes.
5. Prepare for obstacles
6. Ensure longevity.

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FATCA: Notification from the Luxembourg Tax Authorities in case of missing US TIN

In brief

We mentioned in a previous edition (May 2020) the requirement for Financial Institutions to establish FATCA and CRS governance and controls mechanisms as part of a compliance program. The monitoring by different tax authorities about such procedures and notably the data quality of the reports is more and more specific. As a first step of those controls, the Luxembourg tax authorities are currently sending notifications letters to Financial Institutions in order to obtain missing or invalid US Tax Identification Numbers in FATCA reports.

In detail

Following some automatic controls on the 2020 FATCA reports, the Internal Revenue Service ("IRS") notified the Luxembourg tax authorities ("LTA") for each report containing missing or invalid Tax Identification Numbers ("TINs"). The LTA are currently sending letters to all concerned Luxembourg Reporting Financial Institutions ("FIs") including those having used the required explanation codes.
At this stage, those FIs should continue their best efforts to obtain the missing TINs or a proof that their clients or investors are not Specified US Persons (or ceased to be). Based on the results of such ongoing due diligence, they would then need to amend their 2020 FATCA reports by 31 December 2021 accordingly.

A notification has also been sent for Passive Non-Financial Foreign Entities ("NFFEs") with US Controlling Person(s) for which only the Passive NFFE had a missing US TIN. While most of them have valid reasons not to have such numbers (as they are not US entities), the current reporting schema did not allow to not include a US TIN or replace it with a foreign TIN which triggered this error message. As from next year, following an adaptation of the IT systems of the LTA, those entities will be reported with their foreign TIN (normally collected under CRS).

At this stage, the LTA are not asking for any explanations or justifications. However, it is best practice for the FI to keep evidence of the best efforts undertaken to obtain those missing TINs (e.g. annual reminders, blocking of the account, etc.). The LTA also recommends that those efforts are described in the FI's operational procedure.

Even though those compliance steps should help in the case of further requests from the IRS, it remains unclear at this point of time what approach will be taken by the latter in the absence of amended reports as well as the potential consequences if they would consider that the absence of US TIN results from a major non-compliance issue (e.g. treat the entity as a Nonparticipating FFI, request a review of the policies and procedures, ask for an audit of the FI processes, etc.).

Takeaway

This automatic notification is the result of a stricter approach by tax authorities worldwide with respect to the quality of the information exchanged via the FATCA and/or CRS reports. As a result, it is strongly recommended that FIs:

- review their current operating model;
- document how their related procedures are complied with on a day-to-day basis and are tailored to their operational processes;
- ensure relevant employees are regularly trained; and
- strengthen their controls including when client/investor on-boarding and reporting processes are carried out by third-party providers.

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VAT Case Law update - Danske Bank

In brief

The EUCJ has handed down a further judgement concerning the VAT treatment of arrangements between the branch and head office of an entity where those establishments are in different territories, and one establishment is VAT registered within a VAT group.

In detail

Background

This judgement builds on the EUCJ's judgement in Skandia (C-7/13), where it was held that a non-EU branch of a Swedish headquartered company could not disregard supplies between the branch and the Swedish head office, as that head office was itself registered as part of a Swedish VAT group. The membership of the VAT group essentially meant that the head office must be treated as a separate taxable person, from its branch, for VAT purposes and therefore Swedish VAT needed to be accounted for. In the absence of a Swedish VAT group, the supply by the branch would have been to the head office, and therefore within the same legal entity for VAT purposes, and as such would not be within the scope of VAT, following the earlier judgement in FCE Bank plc (C-210/04).

Danske represents a further development to the Skandia principles.

Danske Bank is a company with its principal place of business in Denmark. It carries on its activity in Sweden through a branch (the Swedish branch).

Danske Bank's principal establishment is part of a Danish VAT group established under the Danish VAT legislation transposing part 11 Principal VAT Directive (PVD). The Swedish branch is not part of any Swedish VAT group.

Danske Bank uses a computer platform for the purposes of the activities carried on by all of its business establishments in the Scandinavian countries. The costs associated with the use of that platform by the Swedish branch for the purposes of its activities in Sweden are charged to it by Danske Bank's principal establishment in Denmark. This is essentially the reverse of the facts considered in Skandia, as here the VAT group exists in the territory of the head office (Denmark) and the question is whether there is a supply to the overseas branch (the Swedish branch).

Judgement

In the Danske case the EUCJ has confirmed that the principle set out in the Skandia judgment must also apply where the services are supplied between a principal establishment belonging to a VAT group in one Member State (Denmark) and a branch established in another Member State (Sweden).

Danske Bank's principal establishment is part of the Danish VAT group at issue, and so the EUCJ held, for VAT purposes, that it is the VAT group which supplies the services to the Swedish Branch. The Swedish branch is precluded from membership of the Danish VAT group, despite being part of the same legal entity as its Danish head office. As such, transactions between the Danish VAT group and the Swedish branch cannot be disregarded and must be treated as supplies for VAT purposes. The membership of a VAT group, established in line with Article 11 of the PVD, is the defining factor in the EUCJ's conclusion that the Danish head office must be treated as a separate taxable person from its branch for VAT purposes.

Implications

The outcome in this case is evolutionary rather than revolutionary, simply building on the principle established in Skandia. The EUCJ considered that the membership of a VAT group in a Member State changes the VAT status of the EU VAT group member, whether it is the principal establishment or a branch. The EU VAT group member is a separate taxable person and therefore capable, for VAT purposes, of making supplies to, or receiving supplies from, the different taxable persons in the other Member State.

It should be noted that, in responding to the EUCJ's decision in Skandia, Member States implemented the decision to varying degrees. Territories such as the UK, Ireland and the Netherlands were, and currently remain, of the view that VAT groups can include the overseas branches of VAT group members and as such transactions between them are disregarded as taking place within the VAT group. Those Member States consider VAT groups to extend beyond the geographical borders of their territory to encompass all establishments of members of the VAT group - i.e. they follow a 'whole entity' approach to VAT grouping.

Takeaway

It remains to be seen how Member States will react to this judgement. In particular, the extent to which it will increase the pressure on Member States that follow the 'whole entity' approach to VAT grouping. Other questions of interpretation also remain with regards to whether this principle can be applied to VAT groups in Member States which have provisions that do not conform to the requirements of Article 11 of the PVD and, most critically in light of Brexit, the extent to which these principles apply in respect of non-EU VAT groups.
Banking businesses with VAT groups that operate through branch structures will need to closely monitor developments in response to this judgement, and may consider reviewing and updating risk assessments performed following the Skandia judgement. They may wish to consider reviewing and updating risk assessments performed.

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New guidance from the EUCJ on the scope of the fund management VAT exemption

Key takeaways

On 17 June 2021, the Court of Justice of the European Union ("EUCJ") issued its decision in joined *cases K (C 58/20)* and *DBKAG (C 59/20),* where the scope of fund management VAT exemption was – once more – analysed by the EUCJ.

Although the EUCJ refers to the local court to decide on the application of the VAT exemption for the services at stake, the case provides meaningful insights on the scope of the fund management VAT exemption.

Firstly, regarding the distinct and autonomous character of the services, the EUCJ clarifies that a service, which is specific and essential to the management of a qualifying fund, should not necessarily be outsourced in its entirety to benefit from the VAT exemption. According to the EUCJ, such restrictive interpretation would lead to a limitation of the practical effect of the possibility for outsourced services to benefit from that exemption. In practice, this means that a specific fund administration service delegated on a stand-alone basis may benefit from the VAT exemption. In Luxembourg, this position may, to some extent, be considered as an easing of the current conditions for applying the fund management fund exemption in particular in relation to the concept of "isolated" services which were excluded from the scope of the VAT exemption according to the circular letter n°723 bis dated 30 April 2010 from the Luxembourg VAT authorities.

Secondly, regarding the specific and essential character of the service, the EUCJ reiterates that apart from the tasks of portfolio management, those of administering qualifying funds, such as those set out in Annex II to the UCITS Directive, come within the scope of the VAT exemption. The fact that certain services are not listed in Annex II to the UCITS Directive does not preclude their inclusion in the category of specific services falling within the VAT exemption. In its judgment, the EUCJ is adding concrete examples to the list of services as it suggests that (i) tax-related responsibilities consisting of ensuring that the income received from the fund by unit-holders is taxed in accordance with national law and (ii) the grant of a right to use software used to perform calculations essential to risk management and performance measurement may fall within the exemption. The EUCJ reminds that the services must be intrinsically connected to the management of special investment funds and provided exclusively for the purposes of managing such funds.

While it is important to monitor the final decision of the local court in Austria, this judgment certainly brings additional guidance and clarity on the scope of the fund management VAT exemption. For asset managers and qualifying investment funds, it is an invitation to perform a review of outsourced management services, especially in the fields of software and fund administration services, to confirm whether a VAT exemption could apply.

In detail

1. Facts

In joined *cases K (C 58/20)* and *DBKAG (C 59/20),* the EUCJ was requested to analyse the VAT treatment applicable to services consisting in i) calculation of the taxable income of unit-holders in investment funds and ii) granting of the right to use a software to perform management and risk computations, both performed by external entities to companies in charge of management of special investment funds.

In both cases the *Bundesfinanzgericht* (Austrian's Federal Tax Court) asked the EUCJ if the above-mentioned tasks would be covered by the concept of "management of special investment funds" foreseen in Article 135 (1) (g) of the EU VAT Directive. Due to the similarity of the questions referred, both requests for preliminary rulings were joined in one single case by the EUCJ.

a. K case

In the *K case (C 58/20),* several Austrian management companies externalised – to the service provider K - tasks related to the calculation of the taxable income of unit-holders in investment funds, such as the preparation of tax statements.

In particular, K had to undertake its tax compliance services by using the management companies and custodian banks' income calculations and reproduce the values indicated in the overall balance and in the calculation of income at the level of the funds.

K invoiced its services to the management companies without VAT, considering that these were covered by the VAT exemption applicable to the "management of special investment funds".

b. DBKAG case

In the *DBKAG case (C 59/20),* an Austrian management company acquired the right of use of a third party's software intended to perform computations for the management of risk and performance of special investment funds.

The computations undertaken by the software were subsequently used by the management company for the compliance of its mandatory tasks related to the disclosure of risk and performance of the funds managed.

The management company also acquired, from the same provider, support services (e.g., implementation of the system, software corrections and training of employees).

The management company did not account for reverse charge VAT, neither in respect to the right of use of the software nor in respect to the support services, as it considered that said were covered by the VAT exemption applicable to the "management of special investment funds".

2. EUCJ's decision

In its decision, the EUCJ summarises the reasoning previously presented in other decisions issued in this regard – e.g., cases *Abbey National* (C 169/04), *GfBk* (C 275/11) and *Blackrock Investment Management* (C 231/19) – according to which, in order to be classified as exempt transactions, services provided by a third-party manager must, viewed broadly, form a distinct whole fulfilling in effect the specific and essential functions of the management of special investment funds.

As regards to the requirement that the outsourced functions form a distinct whole fulfilling the functions of the management of special investment funds, the EUCJ rejects the interpretation that only services entirely outsourced may be covered by the VAT exemption.

In the particular case of services consisting of the calculation of the taxable income of unit-holders in investment funds outsourced by the management company in the *K case* and the software to perform management & risk computations acquired by the management company in the *DBKAG case*, the Court argued that taxpayers must be able to choose the business arrangements which best suit them without seeing the benefit of exemption compromised, concluding that the aforementioned services may benefit from the VAT exemption provided they form a distinct whole fulfilling the functions of the management of special investment funds.

Also in line with previous case-law, the EUCJ recapped that the concept of "management of special investment funds" not only covers management functions per se but also administrative tasks strictly related to that management - such as accounting, income computations, mandatory disclosure duties and tax compliance – provided that those are intended to fulfil specific and essential functions of the management of special investment funds.

Also in line with previous case-law, the EUCJ recapped that the concept of "management of special investment funds" not only covers management functions per se but also administrative tasks strictly related to that management - such as accounting, income computations, mandatory disclosure duties and tax compliance – provided that those are intended to fulfil specific and essential functions of the management of special investment funds.

However, and as previously decided in *Blackrock Investment Management* (C 231/19), the CJUE confirms that in situations where a service can be used for the management of special investment funds and also for other types of investments, said service should not be covered by the VAT exemption (as it may not be considered as specific and essential for the management of special investment funds).

Bearing in mind the above, the Court ruled that services such as tax-related responsibilities consisting in ensuring that the income received from the fund by the unit-holders is taxed in accordance with national law and the grant of a right to use software, which is used exclusively to carry out calculations which are essential for risk management and performance measurement, fall within the scope of the exemption if:

1. they are intrinsically connected to the management of special investment funds and

2. they are provided exclusively for the purpose of managing such funds, even if those services are not outsourced in their entirety.

As per the EUCJ, the fulfilment of these criteria should be analysed by the referring national Court.

3. Next steps

Although the reasoning adopted by the EUCJ in its decision is in line with previous case-law issued in this regard, we see that the Court opens a door to outsourced services such as the calculation of the taxable income of unit-holders in investment funds (i.e., specific tax compliance obligations) and the granting of the right to use a software to perform performance management & risk computations to benefit from the VAT exemption set forth for the management of special investment funds.

In fact, as the EUCJ did not directly decide that the services in the cases at hand were considered specific and essential for the management of the special investment funds – leaving said analysis to the referring national Court, which should issue a final decision in this regard in the next few months- business operating in the fund management industry should carefully assess the VAT treatment applicable to services such as tax compliance and use of risk & management software platforms on a case-by-case basis. The case also represents a good opportunity to undertake a wider review of outsourced services with a view to evaluate whether services currently taxable could benefit from a VAT exemption going forward or even for the past.

There is no specific protective claim procedure in Luxembourg and any correction to the VAT treatment of past transactions would have to be done through the filing of amended VAT returns.

In cooperation with PwC Austria, PwC Luxembourg is actively monitoring the outcome of the national proceedings in Austria, so as to analyse if the final decision which is expected to be issued by *Bundesfinanzgericht* (Austrian's Federal Tax Court) confirms the application of the VAT exemption to the services at stake.

There are also on-going discussions on the Luxembourg market between various stakeholders and through professional associations which we are closely monitoring. Further clarification/guidance from the Luxembourg authorities on this case would be very welcome in the coming months.

PwC Luxembourg VAT team is available to help you understand the impacts of this judgment on your business.

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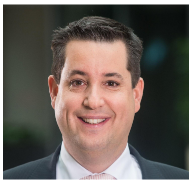

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