The OECD/G20 BEPS Project: where does the Real Estate industry now stand?

November 2017

In brief

It is now two years since the Organisation for Economic Cooperation and Development ("OECD") published its main package of reports on base erosion and profit shifting ("BEPS"). These "Final Reports", marking the culmination of the OECD/G20 BEPS Action Plan set out in 2013, made many recommendations for significant changes to the international tax environment.

Since the BEPS reports were published in 2015, legislators in many parts of the world have worked to begin to implement these OECD recommendations. Also, media and society pressures for an international tax system that operates so that all multinational organisations pay their "fair share" of tax wherever they are active, have continued to grow. Institutional investors are focusing on responsible business conduct: aggressive tax planning is now increasingly seen as a reason for not investing, or even disinvesting, not least because of reputational concerns. It is clear both that tax "climate change" is happening and is irreversible, and that it is increasingly having a significant behavioural impact on taxpayers in all industries, globally.

Progress with implementation of BEPS has been dramatically fastest within the EU. Here there has been a strong and uniform political desire for action, most visible in the way that two key Anti Tax Avoidance Directives, implementing many of the core BEPS recommendations for changes to domestic tax laws, have been legislated over a strikingly short timescale by EU standards – action that has required unanimity by 28 Member States, who must all now have these measures in force by no later than 2019 or 2020.

This Bulletin analyses in some depth the key BEPS measures most relevant to Real Estate funds and their managers. The consequences of BEPS for the sector, and the drivers and timing for changes, that these measures will bring, are each examined.

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Why Real Estate fund managers should care about BEPS

First and foremost, the **strong anti-treaty shopping measures** outlined in the BEPS Project and now being widely implemented, will mean that operating models will probably need to continue to evolve significantly, as a greater degree of **operational activity** in any holding company location as well as a principally **commercial** case for having chosen that location, will usually be essential if tax treaty benefits are to be retained.

Also, for Real Estate funds, the use of leverage as a way of augmenting yields and aiding cash repatriation has historically been prominent. The potential impact of the BEPS measures **restricting the tax deductibility of interest expenses** (now part of an EU Directive), may thus be particularly important for Real Estate funds, with extra, perhaps unforecasted, tax costs eating into net returns to investors.

Furthermore, to the extent a fund vehicle provides internal debt, the BEPS measures concerning "**hybrid mismatches**" (again now mandated by an EU Directive), are likely to both further affect the deductibility of interest, and also potentially to require fund managers to have a full understanding of the **tax attributes** and filing positions **of every investor** in a fund – an extremely tough administrative burden.

Lastly, the fund management business itself is likely to have been set up and run in ways aimed at mitigating tax burdens at both business and owner levels. The BEPS measures strike at this – notably by sharpening the focus both on the **transfer pricing** used, and how it is documented. How fee income from funds being managed is allocated between the countries where fund manager activity takes place, and how internal service fees are set, will both be increasingly scrutinised. A genuine alignment between where profits are taxed, and where real value creation takes place, will be critical.

While many of the measures above will not take effect until 2019 or 2020, fund managers need already to anticipate their consequences, and in some areas begin immediately to make operational changes. Also, in structuring new funds for launch between now and 2019, investors will expect to see the structure chosen as having been, to the greatest extent possible, "future-proofed" for the post-BEPS world.

Tax audit activity in the sector is already growing sharply. Aided by calls for action in the media (and in some cases also by increased government funding), tax authorities will be increasingly confident and assertive in challenging what funds are doing, even when this involves considerable financial and organisational complexity spread over several countries.

Conversely, one important outcome of the BEPS Project that is only now emerging is the recognition of the need for greater "tax certainty". This, combined with the clearer legislative framework and enhanced levels of official guidance that can be expected as the BEPS Project is implemented, may ultimately reduce the scope and size of areas for dispute.

Nevertheless, Real Estate fund managers are, as a generalisation, likely to have to be much more mindful of tax issues and areas for potential challenge when planning their fund structuring. Also, the need for **added tax function** management **resources**, and the costs of resolving disputes (even if little or no tax is eventually conceded as due), will both need to be paid for – with the question arising of how such expenses are to be allocated between fund managers and investors.

The evolution of the BEPS Project since 2015

All the OECD and G20 member countries confirmed in 2015 that they "are committed to the comprehensive BEPS package". Also, since 2015, participation in the BEPS Project has been open to all other countries – the BEPS "Inclusive Framework" currently has 102 countries signed up to the BEPS "minimum standards", this being an explicit commitment to consistent implementation. The OECD sees this in terms of "levelling the playing field". The BEPS Project is now truly global in nature.

The BEPS "minimum standards" apply (among other areas) to anti-treaty shopping measures, and Country-by-Country Reporting transfer pricing measures. An OECD-led peer review process has been set up to monitor, and pressure progress in, implementing these "minimum standards", and this began to publish review reports in 2017. Peer review will be a strengthening driver for BEPS implementation by individual countries not to be delayed.

Another landmark step in the BEPS Project has been the development of the "multilateral instrument". This type of international agreement, novel in the field of tax, allows bilateral double tax treaties to be modified in a synchronised and efficient way. The various BEPS measures that call for double tax treaty modifications can thus become effective, consistently, in many countries at once, and over a rapid timescale. The text of the instrument, formally named the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the "Multilateral Convention") was published by the OECD in November 2016. Following this, 68 countries (including 27 out of the 28 EU Member States) met in Paris on 7 June 2017, and were the initial signatories to this Convention. Governments now need to ratify what has been signed, but one of the more ambitious aims of the BEPS Project is now close to reality.

Also, as already noted, EU Directives that implement many of the BEPS Project measures have now been adopted, having secured the necessary support from all EU countries.

Conversely, since 2105 the United States appears to be less eager to support the BEPS Project. The United States has not signed the Multilateral Convention, believing that the US tax treaty network has a low degree of exposure to BEPS. US tax officials appear to believe that existing US legislation and tax treaties already include most of the measures the BEPS Project recommends. Historically, some parties within the United States have flagged the likelihood that a full implementation of the BEPS Action Plan outside the United States could be very costly for the US economy, as extra taxes paid outside the United States would generate additional tax credits that US groups could use to offset US taxes.

In summary, apart from in the United States, since 2015 the BEPS Project has progressed steadily towards implementation. The political will of the major Member States within the EU to "do BEPS" has been uniform and strong, and so the consequences of living in a "post-BEPS" world are going to be felt soonest and most keenly within the EU.

The measures in detail

Action 2 – Hybrid mismatch arrangements

The BEPS measures

The October 2015 Final Report on this topic covered no less than 454 pages. It was followed in July 2017 by a 99-page further report, dealing with various "branch mismatch" structures not covered in October 2015. The OECD measures outlined below do not represent a required "minimum standard" under the BEPS package: they are recommendations that set an "agreed general policy direction". Countries are thus not obliged to implement these measures, although the EU is doing so.

In principle, the OECD recommended that countries introduce new **domestic legislation** to neutralise the outcomes otherwise arising from what are termed "hybrid mismatch" arrangements. These involve either specific financing instruments, or arise from how entities or branches are characterised for tax purposes under individual countries' rules. The types of "mismatch" were categorised as follows:

- deduction with no taxable inclusion ("D/NI")
- double deduction ("D/D")
- "indirect" D/NI ("imported mismatch").

Specifically, where financial instruments are involved, the definition of what gives rise to a "mismatch" is broadened to cover not just the outright non-inclusion of an income flow, but also where on receipt taxation of the flow is at a reduced rate (e.g. for capital gains) or is potentially significantly deferred.

Some specific examples in the Final Report elaborate various situations that involve "**imported mismatches**". One example accurately described a very typical fund structure, with a fund vehicle and an intermediate holding and financing entity, both in countries that have not introduced effective "anti-hybrid" measures following OECD recommendations, but where there is a portfolio property-owning company taxed in a country that has fully adopted the detailed rules recommended, and which is the ultimate user of the internally-provided funding. If this funding between the fund vehicle and the intermediate company shows "hybrid mismatch" characteristics, then the property-owning company to which the hybrid financing is traceable as flowing would be denied the related interest deduction.

Another aspect of the Final Report recommendations, of particular relevance to Real Estate funds, concerns the scope of application. In principle, the measures are targeted only at flows between "**related" parties**, such as companies that are consolidated for accounts purposes, or which are under common control. However, the recommendations go beyond this, and regard any person who "**acts together**" with another person as causing their rights or interests to have to be combined in order to assess whether a control situation exists. "Acting together" is explicitly stated by the OECD as including a number of investors whose investments are managed under a common investment mandate or who are **partners in an investment partnership**. Consequently, any "hybrid mismatch" situation between a fund vehicle (or, if the vehicle is tax transparent, entities that the fund vehicle owns directly) and any of its investors is caught by the OECD recommendations. It is thought that the OECD Working Party that prepared the Final Report sought this outcome, primarily because of long-standing concerns that investors might be using fund investment strategies in order to **defer** recognition for tax purposes of income.

The Final Report also contained a much shorter separate part which deals with recommendations for amendments to **tax treaties** and changes to the text of the OECD Model Double Tax Convention. The key recommendation was to clarify the treaty position of income that is derived through **tax-transparent entities**. A new clause was recommended to be added to the basic "persons covered" Article 1 of this Model. This confirms that income derived through any "tax transparent" entity (in practice including many types of partnership) is to be treated as income of the person(s) deriving it. While the drafting of the new clause was thus designed in part as an anti-"hybrid entity" abuse measure, it should also helpfully clarify the tax treaty entitlement of investors in partnerships which own assets in "third" countries (i.e. countries other than that of the investor or the partnership). This positive interpretation was explicitly confirmed by the OECD, albeit in the Final Report on preventing treaty abuse (Action 6).

EU Tax Directives implementing

The EU had however already acted in this area even before the October 2015 Final Report was published. A July 2014 **amendment** to the **EU Parent/Subsidiary Directive** had to take effect no later than **1 January 2016** – a requirement that most EU Member States, including Luxembourg, complied with. This two-line amendment to the Directive required the "defensive" rule outlined in the OECD recommendations to be applied, although only in the particular circumstances of a flow arising under any **intra-EU** "hybrid" **financial instrument** – if there is a deduction in the paying country, the recipient EU Member State must tax the income and not allow the participation exemption to apply.

Subsequently, the EU has extended its legislation on "hybrid mismatch" arrangements very substantially, meaning that there has now been a complete implementation of all the BEPS measures.

Firstly, the Anti Tax Avoidance Directive ("ATAD"), was adopted into EU law in July 2016. Given the high level of political support for the overall BEPS Project within the EU, this Directive, expressly seeking to implement all the BEPS recommendations for changes to domestic legislation not linked to transfer pricing (as well as mandating a general anti-avoidance rule and other measures targeting tax avoidance), moved from an initial draft to unanimous agreement between the 28 EU Member States in less than six months. One article in the ATAD was a four-line provision that simply dealt with double deduction and deduction/ non-inclusion situations generically. However, the ATAD called for more specific measures to be developed to deal with "hybrid mismatches", and recognised that this four-line provision was simply a stop-gap.

Work at the EU thus continued through late 2016, with the publication in October 2016 of the first draft of an amending Directive ("**ATAD II**"), augmenting ATAD and covering any "hybrid mismatches" with third countries as well as between EU Member States. The ATAD II text, in a form significantly further tightened compared with its first draft, was unanimously agreed by EU Finance Ministers in February 2017, and adopted into EU law on 29 May 2017.

ATAD II aimed to follow the OECD October 2015 Final Report and subsequent thinking on specific "branch mismatch" aspects closely. Recitals to ATAD II confirm that it is intended to have "*rules consistent with and no less effective than*" the Final Report. Furthermore, EU Member States are told to "*use the applicable explanations and examples in the [Final Report] as a source of illustration or interpretation to the extent that they are consistent with the provisions of this Directive and with Union law*".

The key points within ATAD II include the following:

- The basic rules of the OECD recommendations are also the core provisions of ATAD II.
- Where there is a "hybrid mismatch" that gives rise to a **double deduction**, then the primary rule is for the deduction to be denied in the "investor" jurisdiction (i.e. the Member State which is <u>not</u> the source of the payment), and the defensive rule is for the deduction to be denied in the "payer" jurisdiction (i.e. the Member State that <u>is</u> the source of the payment).
- Where there is a "hybrid mismatch" that gives rise to a **deduction without inclusion**, then the primary rule is for the deduction to be denied in the "payer" jurisdiction Member State, and the defensive rule is for an equivalent amount to be included in income in the "payee" jurisdiction Member State.
- What constitutes a "**hybrid mismatch**" is defined by way of outcome. Any double deduction is caught, and six different types of deduction without inclusion situation are caught. These include payments under financial instruments, and payments to a "reverse hybrid" entity.
- A "**reverse** hybrid" entity is one which is treated as transparent for tax purposes in the country where it is set up, but not by the country where its owner or owners are resident – meaning that neither country concerned would normally seek to tax its income on receipt.
- If a deduction without inclusion situation arises under a **financial instrument**, then there is a "hybrid mismatch" if (and only if) the mismatch is caused by a difference in **characterisation** – typically because the "payer" jurisdiction treats the instrument as debt, and the "payee" jurisdiction treats it as equity. A mismatch arises not only if income is completely tax exempted because of its character – it also arises if the character of the income causes it to benefit from any type of tax relief such as a reduced tax rate (e.g. for capital gains). Conversely, there is no mismatch if the ONLY reason for tax exemption or relief is that the recipient is in a zero tax jurisdiction, or has a special tax status (e.g. is a tax exempt fund).
- In situations involving financial instruments, there is only a "hybrid mismatch" if the "payee" jurisdiction does <u>not</u> include (i.e. tax at the full normal rate) the income within a "**reasonable period of time**". ATAD II is more precise than the OECD, defining this as either as being taxed in a period starting within 12 months of the end of the payer's tax period, or if the terms of payment are "arm's length".

- As with the OECD recommendations, ATAD II requires the mismatch outcome to arise between "**associated enterprises**" before it falls within the scope of the measures. However, in assessing whether enterprises are "associated", the "**acting together**" rule that requires holdings to be aggregated also applies in the same way as under the OECD recommendations. What constitutes "acting together" is not specified in ATAD II – but, as previously noted, ATAD II recommends interpretation consistent with the OECD work. Hence if ATAD II is transposed into domestic legislation with this approach being taken, investors in many funds will at least indirectly be within the scope of the ATAD II measures.

- ATAD II includes a notably broad "**imported mismatch**" rule – any payment that funds deductible expenditure via transactions between associated enterprises shall be denied a deduction unless another jurisdiction has made an equivalent adjustment.

- ATAD II includes a specific further measure concerning **reverse hybrid entities** controlled by non-residents (Article 9a) – where applicable these will over-ride the basic rule that deals with deduction without inclusion outcomes involving reverse hybrid entities. The special rule will force the otherwise tax-transparent hybrid entity to be treated as a **taxable** resident and taxed on income that is taxed nowhere else.

Timeline

The United Kingdom moved directly to implement all the BEPS measures into its domestic law, with very comprehensive (EU Directive-compliant) legislation that took effect, quasi-retrospectively, on 1 January 2017.

Because **ATAD II** was a "patch" on the main ATAD, the same transposition/ application timetable (with all EU Member States expected to have all provisions in effect from 1 January 2019) was originally planned. However, in finalising the ATAD II text, a one-year delay was agreed, and hence the main coming into effect of the ATAD II measures across the EU thus now has to be no later than **1 January 2020**. (It should be noted that the ATAD II text has completely replaced the original ATAD four-line provision, and hence there will be no interim rules applying under ATAD for 2019.) It is not expected that Luxembourg will bring these measures into force before this deadline, but it is not yet clear if other EU Member States will move sooner.

Some special rules under ATAD II dealing with reverse hybrid entities controlled by non-residents (Article 9a) do not have to come into effect until **1 January 2022**. Also, ATAD II does not disturb the measures amending the EU Parent/Subsidiary Directive effective from 1 January 2016 – these earlier measures are confirmed by ATAD II (see its Recital 30) as operating in priority to the ATAD II rules.

At the time of writing, it remains to be seen how EU Member States will transpose ATAD II. The text of ATAD II is some 12 pages long, but is still very principles-based. Some EU Member States may try to follow the ATAD II wording closely when transposing, and others may opt for more elaborate and precise text. Inevitably, there will be some inconsistencies between countries. However, given the way in which ATAD II includes "defensive" and "imported mismatch" rules, the outcome will generally be that the strictest country in any chain of income flows will be able to deny a deduction for a payment, even if other EU Member States have sought, perhaps for policy reasons, to take a more moderate approach to transposing the ATAD II measures.

Outside the EU, relatively few signs have been observed that the BEPS Final Report measures are being implemented. Indeed, at the time of writing, only Australia is thought to be acting in this area.

Separately, implementation of the **treaty-changing measure**, which confirms that benefits under a relevant treaty still apply when looking through transparent entities, is now in progress – Article 3 of the OECD Multilateral Convention, now already signed by 71 countries, included the text needed to allow this necessary revision to tax treaties. While signatories to this Convention could exercise the right to "reserve" against this Article (i.e. opt for it not to apply), few have in fact done so. Hence, once signatories that accept this Article have ratified the Convention (or ratified equivalent changes to individual treaties) this treaty-changing measure will take effect – for many treaties this will be from 1 January 2019, and extending further through the global treaty network thereafter.

Consequences for Real Estate funds

Unlike the changes to the EU Parent/Subsidiary Directive that have had effect since 2016, the consequences of ATAD II look to be of major significance for the Real Estate funds sector.

Most importantly, the financing by the fund vehicle of any underlying holding and financing "platform" (a very common component of Real Estate fund structures) will need to be examined very carefully.

Firstly, this will need to be done in the context of the ATAD II rules concerning **financial instruments**. Some types of financing commonly used at this level, particularly in older funds, are highly likely to be giving rise to "hybrid mismatches".

Additionally, many fund vehicles will be at risk of being seen as **"reverse hybrid" entities** under ATAD II.

Furthermore, application of the **"imported mismatch"** measures by any EU Member State where investments are held and financed by internal debt will also be an important concern.

Any of these issues could cause very significant **interest costs** to be **non-tax deductible**. All arise principally because of the "acting together" rules, recommended by the OECD and endorsed by the EU, which would cause investors to be treated as associated with the fund they invest in. The tax outcome within the fund vehicle, or entities that it controls or owns, then becomes driven by the **tax attributes of each and every investor in the fund**, and by **how the investor characterises the fund** vehicle from a tax perspective. This latter issue will be of particular relevance for US investors.

This new BEPS-driven ATAD II legislation presents difficult challenges for Real Estate fund managers that have structured funds using internal debt. Firstly, in order to manage both the tax efficiency and tax compliance obligations of the "platform", as noted above potentially it will be necessary to know the tax attributes of **all** ultimate "opaque" investors. This could be a massive, and possibly impracticable, burden. Secondly, in order to retain fairness between investors, more complex feeder fund and profit allocation mechanisms might need to be put in place, to segregate investors whose tax treatment causes non-deductibility in the structure.

Because of these issues, it is increasingly possible that fund managers will in the future simply opt to structure (or restructure) fund "platform" financing so that it has equity characterisation at all levels. This would potentially mean accepting additional withholding tax leakage, and loss of flexibility in profit repatriation, as well as lesser tax deductibility in the structure. That said, deductibility of financing at property-owning company level may in any event be constrained by the BEPS Action 4/ ATAD measures that set an overall cap on interest deductibility, outlined further below.

Separately, as regards the **treaty changes** clarifying the tax treaty entitlement of investors via transparent entities, these could be **helpful** to some institutional investors (e.g. pension funds) in partnership-type Real Estate fund vehicles, who would more readily be able to use their own treaty entitlement status to secure treaty benefits on their share of income flows into the fund vehicle. However, mechanisms to ensure that tax authorities in the countries where a fund invests grant reduced rates of withholding tax, ideally at source, will in many cases need to be made to operate more effectively before this treaty change, once effected, can bring tangible benefits.

Action 4 – Interest deductions

The BEPS measures

The perceived risk of "base erosion" due to excessive interest deductions, highlighted in the original 2013 BEPS Action Plan, was addressed in the October 2015 Final Report on this topic, through linking net interest deductions to taxable economic activity. These 2015 OECD measures do not represent a required "minimum standard" under the BEPS package: they are recommendations that set an "agreed general policy direction". Countries are not obliged to implement these measures, although again the EU (and thus all its Member States) is doing so.

An entity's overall interest burden – i.e. interest and similar expenses incurred on both related party and third party financing – falls within the scope of the recommendations, which to a large extent are based on the regime that has been in force in Germany for around the last ten years. The primary rule is to limit the overall amount of interest that can be deducted using a "fixed ratio" rule, based on a "**net interest"/ EBITDA ratio**. Countries were recommended to set this ratio, capping the amount of interest that is deductible, at between 10% and 30%. The OECD identified various factors which it hoped would help individual countries set an appropriate ratio.

EU Tax Directive implementation

The BEPS recommendations have now been written into EU law, and are thus well on the way to being implemented across the EU. The ATAD, adopted in July 2016, contains as its Article 4 an "interest limitation rule" that closely follows the OECD recommendations. The ATAD applies to net interest expense, terming this as "exceeding borrowing costs". As is also the case with the existing German regime, the **"net interest"/ EBITDA ratio** which caps the amount of interest that is deductible is set at **30%**. EBITDA is to be calculated based on tax-adjusted amounts of interest and depreciation, with **tax-exempt income** to be **excluded** from the EBITDA amount.

Other important features of the ATAD interest limitation rule include:

- A ***de minimis*** derogation – exceeding borrowing costs up to **EUR 3 million** can always be deducted. This limit applies once to a tax group as a whole, where domestic law allows or requires some form of tax consolidation.

- Exclusion from the scope of the ATAD measures for "standalone" entities that are not part of an accounting consolidation and have no associated companies.

- Discretion being given to EU Member States transposing the ATAD into domestic legislation to **exclude** from the scope of the ATAD rules exceeding borrowing costs linked to **loans** concluded **before 17 June 2016** – but this exclusion cannot extend to any subsequent "modification" of such loans.

- A similar discretion to exclude loans financing long-term public infrastructure projects – i.e., linked to the general public interest – but only so long as the project operator, the borrowing costs, the assets financed and the income flow are all within the EU.

- For taxpayers that are part of a consolidated group, the benefit of **either of two** sets of **group ratio rules** can be applied. Under an "equity escape" rule, there is a right to fully deduct exceeding borrowing costs if the ratio of equity/ total assets is equal (or is lower by less than 2%) or higher than the equivalent ratio for the group. An OECD-style "group ratio" rule also applies: if a consolidated group has "exceeding borrowing costs" of above 30% of group tax EBITDA, then this higher ratio can be applied by the taxpayer.

- In transposing the ATAD into domestic legislation, EU Member States have considerable flexibility. They may allow "carry-forward" without time limitation of exceeding borrowing costs that cannot be deducted in a particular tax year; "carry back" of such exceeding borrowing costs for maximum of 3 years; and/ or "carry-forward" of unused interest capacity for a maximum of 5 years

- For the time being, EU Member States can exclude from the scope of the ATAD measures financial undertakings (including AIFMs and UCITS management companies – but not the fund "platforms" that they manage) and insurance undertakings – these two sectors were said to present special features which called for a more customised approach "in the future" (ATAD was adopted shortly before the OECD published further guidance in this area).The BEPS recommendations have now been written into EU law, and are thus well on the way to being implemented across the EU. The ATAD, adopted in July 2016, contains as its Article 4 an "interest limitation rule" that closely follows the OECD recommendations. The ATAD applies to net interest expense, terming this as "exceeding borrowing costs". As is also the case with the existing German regime, the **"net interest"/ EBITDA ratio** which caps the amount of interest that is deductible is set at **30%**. EBITDA is to be calculated based on tax-adjusted amounts of interest and depreciation, with **tax-exempt income** to be **excluded** from the EBITDA amount.

Timeline

Real Estate fund managers operating in Europe are likely already to be familiar with measures of this nature, as not only Germany but domestic regimes in **several** other **European countries** have already gone down this route and have **legislation already in force**. The United Kingdom introduced, again quasi-retrospectively, with effect from 1 April 2017 very detailed "corporate interest restriction" legislation that closely followed the OECD recommendations.

EU Member States are in principle required to transpose and have in force the **ATAD** Article 4 "interest limitation rule" no later than **1 January 2019**. However, where targeted rules that are equally as effective as the ATAD measures are already in force, EU Member States can defer this deadline until 1 January 2024 (or sooner, if in the meantime the OECD imposes a "minimum standard" in this area). It is unclear as yet which EU Member States might be able to apply this deferral, although Germany is almost certainly entitled to.

Consequences for Real Estate funds

Real Estate fund managers will need to **keep under close review** the full details of the timing and way in which each individual country invested in moves to implement the ATAD or (outside the EU) the BEPS recommendations. Indeed, how individual countries choose to adopt the measures could even affect decisions on where to make new investments, and when and how to exit existing ones.

Careful tailoring of financing structures, in order to minimise the adverse effect of new measures, will be essential. As noted above, some EU Member States may opt to exclude from the scope of the ATAD rules exceeding borrowing costs linked to loans concluded before 17 June 2016, although the ATAD specifies that this exclusion "cannot extend to any subsequent modification of such loans". (Little further clarification has yet emerged of what this "no modification" restriction on this "grandfathering" clause actually means in practice, and it is likely that individual countries that opt to allow "grandfathering" will each make their own rules.) Although it is not yet known either whether <u>any</u> countries will allow "grandfathering" or how, since the final text of the ATAD was published in June 2016, this issue has been an important consideration whenever any **refinancing or other changes** to the terms or principal of **loans made before 17 June 2016** has been contemplated. A specific issue has been the tension between this need for "no modification", and pressures to make changes to comply with new transfer pricing rules and practices.

There is a real risk that in the medium term (and certainly within the EU once the ATAD rules come into force on 1 January 2019), the overall degree of BEPS-driven change in tax regimes in this area could end up having a **notably negative effect on investor returns**. Sharply defined and low fixed limits on interest deductibility, together with measures specifically designed to preclude the deduction of financing costs incurred to acquire shareholdings, could increase materially the tax burdens within individual investments made by many Real Estate funds.

Action 6 – Preventing treaty abuse

The BEPS measures and timeline

The October 2015 Final Report on preventing treaty abuse confirmed that all participants in the BEPS Project were committing to implementing measures that meet "minimum standards" in countering "treaty shopping". Indeed, the OECD wished there to be a particularly strong level of compulsion here.

However, it was clearly recognised that there had to be flexibility built into the measures proposed – which centre on an entirely new article being included in the OECD Model Double Tax Treaty text – in order to allow adaptation to each country's specific circumstances and previously-negotiated bilateral tax treaties.

Three alternative approaches to structuring the text of this new "Entitlement to Benefits" tax treaty article or clause were outlined, as follows:

- A single-paragraph **principal purpose test** ("**PPT**"), providing that benefits under a tax treaty shall **not** be granted, if it is reasonable to conclude that obtaining that benefit was one of the principal purposes of any arrangement that resulted in that benefit.

- A US-style **limitation on benefits** ("**LoB**") set of rules, plus "anti-conduit" rules. Under LoB rules, only "qualified persons" are granted treaty benefits. The definition of "qualified person" could extend to two or three pages of treaty text, but in essence individual physical persons, quoted companies, their same country subsidiaries, and other companies that would still get the same level of treaty benefits if the income flow was direct to their owners would qualify. Sovereign wealth funds would also qualify, and so would many pension funds. However, because of their somewhat binary nature, LoB rules are generally not helpful for alternative investment fund vehicles, or the holding and financing companies they control.

- **Both** the LoB set of rules, and a PPT.

The exact form of wording to implement the necessary tax treaty changes, which emerged when the text of the **OECD Multilateral Convention** was published in November 2016, showed a change in emphasis, towards purely the **PPT as being the "default"** way for countries to satisfy this "minimum standard", which forms the cornerstone of the BEPS Project. The overall text of Article 7 of the Multilateral Convention, entitled "Prevention of Treaty Abuse", is extensive and complex. However, the wording of the PPT within the article was not changed in any material way from the October 2015 Final Report, and provides as follows:

> *"… a benefit under a Covered Tax Agreement shall* ***not*** *be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit …"*

This trend towards the predominance of the PPT has now become even more evident following the initial signing ceremony of the Multilateral Convention in Paris on 7 June 2017, at which countries formally committed to BEPS-driven tax treaty changes. Of the 67 countries that initially signed and made clear their intentions regarding application (including 27 out of the 28 EU Member States), 51 opted for the PPT to be the **only** way in which their tax treaties were to be amended in order to meet the BEPS "minimum standard". Another 7 countries (including Canada and Poland) opted for the PPT, but intended to also renegotiate treaties bilaterally to include a very detailed, US-style LoB clause. Only 9 countries (including Russia, India, Mexico, and (as the only two EU Member States) Bulgaria and Slovakia) insisted that they also wanted to seek inclusion of LoB measures through the Multilateral Convention, which in its Article 7 wording largely follows the "simplified" alternative version of the October 2015 Final Report.

The PPT will thus begin to take effect after signatories complete their processes for ratifying the Multilateral Convention, or ratifying equivalent changes to individual treaties. Under the mechanism of the Multilateral Convention, both parties to a bilateral treaty must accept a provision set out in the

Multilateral Convention before the Convention can make a treaty change happen. Because so many countries have accepted the PPT (in one way or another, all 68 signatories (China having signed on behalf of Hong Kong) to date), adoption of the PPT should now be swift and widespread, as it is now only being delayed by ratification processes. Under the timetable set out in the Multilateral Convention, for many treaties the date that the **PPT** will **take effect** is likely to be **1 January 2019**, and it should extend further through the global treaty network rapidly thereafter.

The OECD has also recognised that **guidance** needed to be given on how the PPT might apply in practice, and that this should be done by way of text that would appear in the Commentary section of the OECD Model Tax Convention. Ten examples were set out in the text of the 2015 Final Report that were in due course to amend the Commentary, although none of them were of specific relevance to the Real Estate funds sector.

The Final Report did however acknowledge that more work needed to be done in the area of alternative investment funds. The OECD refers to such funds as "non-CIV" funds – in other words funds that do not fall within the long-established OECD definition of "collective investment vehicles" because they do not have all three of the key attributes set out in that definition – namely "*funds that are widely held, hold a diversified portfolio of securities, and are subject to investor-protection regulation in the country in which they are established*". Particular concerns had repeatedly been raised in OECD Working Parties (i.e. by senior tax officials) that non-CIVs could be used to allow persons <u>not</u> entitled to treaty benefits to access such benefits indirectly, and also that non-CIVs could be used as a way for investors to defer income recognition.

A conclusion on the position of "non-CIVs" emerged in July 2017, with the publication by the OECD of a final draft of the "post-BEPS" version of the OECD Model Tax Convention. This added a new Article 29 on "Entitlement to Benefits", as well as some 70 pages of Commentary on this Article, covering both the LoB and PPT measures. Included in the Commentary text (see paragraph 182) are the ten PPT examples already noted. Also three new, detailed positive examples (Examples K, L, and M), each of situations involving "non-CIVs" and entities that they control and where the PPT should <u>not</u> be regarded as restricting treaty benefits.

It remains to be seen how tax authorities will interpret or augment this Commentary guidance. While there was no explicit recognition that a "same country" framework, with both the fund vehicle and a holding and financing "platform" established and running in the same location (as can readily be done in Luxembourg), should be a strong positive factor in concluding that the PPT should not affect income flows, this should clearly be the case.

EU actions and timeline

The EU had already moved in the "PPT" direction, in introducing in January 2015 a "**common minimum anti-abuse rule**" – i.e. what is in effect an anti-"Directive shopping" measure – into the EU Parent/ Subsidiary Directive. This amendment to the Directive was expressly BEPS-driven, and imposed a requirement for there to be "*valid commercial reasons which reflect economic reality*" within any holding structure, for Directive benefits to continue to be available. This requirement is consistent with (although not as strict as) what later emerged as the final version of the PPT.

EU Member States were required to transpose this Directive amendment into domestic law before the end of 2015, with the changes having to come into effect no later than 1 January 2016.

Luxembourg, notably, has complied fully with this obligation, and issues are already arising over how the measure could apply in practice. Notably, application of the EU Parent/ Subsidiary Directive-mandated exemption from withholding taxes has been questioned, in a situation where a dividend is paid by a Luxembourg company to a parent established elsewhere in the EU that has only a minimal level of substance.

There has been many discussions at EU level over whether a similar "common minimum anti-abuse rule" should be added to the Interest & Royalties Directive. No agreement on this had been reached at the time of writing, mainly because some, but not all, EU Member States would wish to see more far-reaching restrictions applying instead. Nevertheless, it should be expected that EU Directive measures imposing a similar “substance” requirement before intra-EU interest flows can continue to be paid without withholding tax (from EU Member States that otherwise levy such a withholding under their domestic legislation), could well be brought into effect by 1 January 2019 or 2020.

Lastly, the EU, while strongly supportive of the OECD actions to curb treaty shopping, has recognised that it cannot dictate how individual EU Member States implement tax treaty changes, even when these have been recommended by the BEPS Project. Nevertheless, in January 2016, the EU Commission, as part of its Anti-Tax Avoidance Package, made recommendations to EU Member States on making BEPS-led treaty changes. The main recommendation referred to the BEPS Action 6 work on preventing treaty abuse, and was to choose the PPT (albeit in a slightly qualified way, in order to be more certain of retaining consistency with existing EU law) as the preferred way to revise treaties.

Consequences for Real Estate funds

Firstly, it is clear that many Real Estate funds, led by their managers, have over recent years already evolved, refined and up-resourced their operating models. The commercial reasons for including holding and financing “platform” companies in the fund structuring have increasingly been more explicitly recognised, prioritised and acted upon. Equally, the level of “operational activity” at the holding and financing “platform”, both in terms of headcount and office space, and of the involvement of locally-based staff in governance processes, has emphasised the economic reality of such an operating model.

Hence for many funds, the “common minimum anti-abuse rule” within the EU Parent/ Subsidiary Directive has become an issue that – while still a concern given its essentially subjective nature and hence susceptibility to tax authority challenge – is seen as manageable. A holding and financing “platform” with sufficient real economic activity is potentially able to have the amendment to the Directive apply without seeing its tax burden on intra-EU dividend flows increase.

Secondly, the outcome of the process for implementing the BEPS measures that aim to prevent treaty abuse has also been less negative than many commentators had feared. The predominance of the PPT, rather than LoB rules, as the choice of approach by the many countries that have now signed the Multilateral Convention, means that there will be far fewer situations where the black/white binary outcome of an application of an LoB rule leads automatically to all entities within a structure controlled by a Real Estate fund being denied treaty benefits. The subjectivity of the PPT gives at least the possibility for funds’ holding and financing “platforms” to retain treaty benefits within the network of treaties, once the relevant treaties have in effect been amended by the Multilateral Convention.

However, the guidance that has now emerged so far from the OECD, in the form of the Commentary “non-CIV” Examples K, L, and M, does appear to set the benchmark for aligning income flows and economic activity at a high level. Conversely, these examples do, to a good and reassuring extent, genuinely reflect common arrangements entered into by “non-CIVs”. The examples should be read broadly (they are stated to be “purely illustrative”, and “not providing conditions or requirements”), and thus it should not be necessary to go as far as fitting precisely in to a stated fact pattern before comfort can be taken that the PPT does not “bite”.

Another encouraging feature of two of the three examples is that they reiterate the wording, first used in the examples of PPT application included in the 2015 Final Report, stating that “*the intent of tax treaties is to provide benefits to encourage cross-border investment*”. This positive and explicit restatement of such a basic principle, perhaps at times not heavily enough weighted in some of the thinking during the BEPS Project, is much welcomed.

Looking firstly in more detail at the text of Example K – which describes a “regional investment platform” – the fact pattern is described as follows.

Who?	“Fund”, an “institutional investor” – established, and tax resident, in a country, – “subject to regulation” there. Owning a company resident in another “platform” country, operating exclusively as a “regional investment platform”. Acquiring and managing a “diversified portfolio of private market investments, located in a number of countries in a regional grouping.
Choice of location mainly driven by?	Availability of directors with knowledge of regional business practices and regulations. Skilled multi-lingual workforce. Platform country in regional grouping. Platform country has an extensive tax treaty network, with low withholding tax rates.
“Platform” activities	Experienced local management team that reviews investment recommendations, and performs various other function, which may include: – approving and monitoring investments, – treasury functions, – ensuring regulatory compliance. Board, appointed by Fund, comprising: – majority locally resident in platform country, who have expertise in investment management, – and members of Fund’s global management team.

The underlying message of this example is that a “platform” can still potentially reduce withholding tax leakage, because, due to the significance of commercial motives and drivers, it can still be allowed to benefit from the tax treaty network. Perhaps the most significant aspect of the above example is the high – but not at all unrealistic – benchmark that is set above for activity and governance.

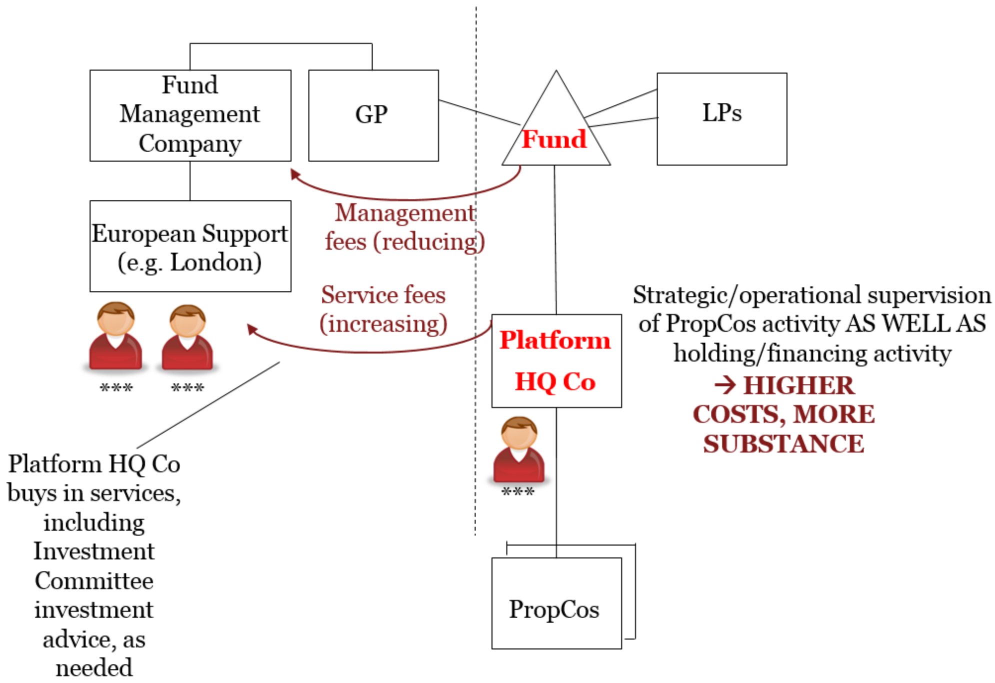
Moving to example M of the Commentary, this is explicitly focused on a Real Estate fund structure. The fact pattern described is as follows.

Who?	- "Real Estate Fund", a tax transparent fund vehicle, managed by a regulated fund manager - Investors are institutions such as pension schemes and sovereign wealth funds - Investors are resident in a range of different jurisdictions - Fund investment strategy not driven by investors' tax positions – seeks to maximise value of real estate and realise appreciation through disposal - Real Estate Fund owns a holding company not resident in the country where the fund is set up
Why a holding company?	- Commercial and legal reasons – protect Fund against claims against real estate assets - Facilitates debt financing - Facilitates acquisitions, management of assets, disposals - BUT ALSO to facilitate withholding tax relief claims (as otherwise individual investors would have to make these)
Choice of location mainly driven by?	- Access to appropriately qualified people - Political stability - Good regulatory and legal systems - Investor and lender familiarity - Extensive tax treaty network, especially with countries targeted for investment - BUT holding company tax treaties NOT better than treaties between property-situs countries and investor countries
Holding company activities	- Manages the real estate assets, but holds them indirectly via property-owning companies, resident where the real estate is sited - Provides debt and/or equity financing to the property-owning companies - No specific other expectations regarding management activity or board composition

This example is arguably less helpful in any discussion of whether the PPT should not apply, as in reality inclusion of the holding company would often cause withholding tax levels to be lower than if flows were directly from property-situs countries to at least some investors. However, the example does recognise how common this type of structuring is, and still lends good support to the position that a Real Estate fund with a range of institutional investors that puts in place a holding and finance company, and that does so for a variety of commercially-driven reasons including those listed above, should be able to asset that the PPT should not apply. The withholding tax situation is arguably one "purely illustrative" component of the fact pattern, and a fund with investors who are mostly treaty-entitled should be able to argue that not too much weight should be attached to this one factor.

Stepping back from the detail and drawing broader conclusions, these OECD Commentary examples do certainly emphasise that, for the PPT not to apply and thus for treaty benefits to remain available, commercial drivers need to predominate when the motives for choosing a particular structure within a Real Estate fund are examined. This might certainly put pressure on some Real Estate funds to evolve their operating models to bring senior management functions into "platform" companies, with the consequence that there would be a switch of the cost base away from fund manager-controlled entities, and compensated for with reduced management fees.

The Fund and "Platform" HQ Co – towards a "substance" solution?



This enhanced level of operational activity, evidenced by a materially increased cost base being booked at the holding and financing company "platform" level, is very much in line with the "Platform HQ company" model (summarised diagrammatically above) that has been seen as a potential solution to the "substance" debate ongoing since even before the BEPS Project was announced in 2013, but having become much more acute and intense once the BEPS Project took on "substance" as one of its core themes.

There do now appear to be better prospects, certainly than had perhaps been anticipated at the time the 2015 BEPS Final Reports emerged, for Real Estate funds to be able to retain tax-treaty benefits in the post-BEPS environment, provided that all arrangements in place have strong commercial drivers supporting them. Also, "platform" or holding companies will be required to have the high level of functions needed to satisfy one of the main goals of the BEPS Project, this being to have income flows much more closely aligned with the economic activity that generates that income. A view is certainly currently emerging that "more substance" (justified by commercial considerations) is the way forward – and that it is still too soon to be embarking on more radical fund restructuring measures, which place less reliance on tax treaty protection, or shift entitlement of tax treaty benefits to the investor level.

What is also increasingly clear is that business operational models that do not have adequate substance at holding and financing platform level will increasingly be challenged, and will become unsustainable in the short to medium term.

Indeed, in Luxembourg, a typical jurisdiction in which to set up a real estate fund and a "platform", there are already clear signs that fund managers are adapting to these demands, seeing commercial drivers for switching headcount, senior management activity and functions into Luxembourg "platforms". Furthermore, in setting up new funds, the choice of a Luxembourg fund vehicle, to combine with the "platform" and further enhance its commercial rationale through it being a "same country" operation, is becoming an increasingly attractive, and more frequently chosen, option.

Action 7 – Artificial avoidance of permanent establishments

The BEPS measures

One of the concerns flagged by the BEPS Action Plan was that some multinational groups were using the way in which double tax treaties define "permanent establishment" (broadly, a taxable presence) to step to the side of the line that meant their operations in a country were protected by treaty from being taxed. The Action 7 recommendations set out in the October 2015 Final Report were thus centred on redrafting the "**permanent establishment**" article in the OECD Model Double Tax Convention, together with its relevant Commentary, to **widen its application** in **tax treaties**.

The Final Report proposed a widening of the "dependent agent" test, a narrowing of the "independent agent" exemption, and a tightening of the specific activity exemptions from PE status. The OECD sought to extend the scope of the "dependent agent" test, so that it expressly included certain specific contract negotiation activities. However, the test finally settled on focused on agency activities that involve concluding contracts, or playing "the principal role leading to the conclusion of contracts that are routinely concluded without material modification [by the principal]". The guidance on these tests was somewhat blurred, probably because of the last-minute nature of the consensus agreement here.

Timelines and EU actions

The EU Commission January 2016 Anti Tax Avoidance Package recommendation on BEPS-led tax treaty changes (noted above in the context of the Action 6 measures) was that EU Member States should simply seek to introduce into their tax treaties <u>all</u> the OECD-recommended changes to the definition of "permanent establishment".

Steps to implement these treaty-changing measures are now in progress – Articles 12 to 15 of the OECD Multilateral Convention contain the necessary text, which is, as expected, based on the October 2015 Final Report recommendations. Hence, once countries that have accepted this Article have ratified the Convention (or ratified equivalent changes to individual treaties) this treaty-changing measure will take effect – for many treaties from 1 January 2019.

However, because Action Point 7 is not a BEPS "minimum standard", signatories to the Convention can exercise the right to "reserve" against these four Articles and thus opt out of having to apply them. Luxembourg, Ireland and the United Kingdom are three major centres for fund management that have each taken this course of action. None of the tax treaties that these countries have entered into will thus be amended, unless and until they take a new stance waiving the right to "reserve".

Consequences for Real Estate fund managers

While the OECD's main target has been perceived abuses by groups that are major players in the "digital" economy (with some cases receiving much attention in the media), the treaty changes could mean that the activities of Real Estate fund managers when prospecting for deals, or supervising investments, could be at much greater risk of creating tax "footprints" in more countries for the Real Estate fund manager group, or if such a "footprint" already exists, of having a much greater share of group profits attributed to it and taxed there. This is primarily a "house" tax issue.

To the extent that the entity within the Real Estate fund manager group that is at risk of creating unanticipated tax "footprints" is resident in one of the countries that has opted <u>not</u> to have the Multilateral Convention change its tax treaties, then in theory the situation will not change from the present position. However, the BEPS-led focus on this topic, and the possibility that the jurisdiction where activity is taking place <u>is</u> one which has a strong preference to see treaty change effected, is likely to be a catalyst for many more tax authorities to act using existing rules. More aggressive policing of existing treaty exemptions by tax authorities should thus be foreseen.

Real Estate fund managers should ensure that internal procedures covering marketing, capital raising, and deal sourcing, are carefully drawn up with this tax "footprint" issue in mind. Both "fly-in" activity and local "rep office" activity need to be covered, and key senior staff (they being the most likely to be involved in decision-making on contracts) be made fully aware of the issues.

Actions 8-10 – Transfer pricing

The BEPS measures

The BEPS Action Plan had as one of its main themes ensuring that **transfer pricing outcomes are fully aligned with value creation**. The Final Report included guidance on several key transfer pricing areas. Almost 200 pages of guidance text was included, and this almost completely rewrites large parts of the OECD Transfer Pricing Guidelines, which were re-published in their “post-BEPS” form in July 2017. New key principles that have emerged include the following:

- The “accurate delineation” of intercompany transactions is paramount, and the conduct of the parties must prevail over contractual arrangements where there is a misalignment between the two.
- A six-step process for identifying risk is outlined, with the return for risk to be allocated to the party that controls the risk, and has the financial capacity to assume it.
- Returns from intangibles (which include know-how and industry expertise) must accrue to the entities that carry out the development, enhancement, maintenance, protection, and exploitation functions, and not necessarily to the legal owner of the intangibles.
- For low-value adding intra-group services, a “safe harbour” of a 5% cost plus mark-up percent is recognised.

Consequences and timeline

For Real Estate fund managers, this enhanced focus by the OECD on “where is value added?”, “what are the intangibles in your business?”, and “which entity is paying for your risk controls?” may have important consequences. Within the “house”, where profits are currently being booked needs to be carefully examined, and the transfer pricing methodology, the fact patterns on which pricing is based, as well as the benchmarks being used all revalidated, to ensure compliance with this new approach. Situations where the intangible of important expertise is being contributed by a group entity, but where it is rewarded purely on a “cost plus” basis, may need particularly careful review. Also, the importance of a “house’s” brand in terms of capital raising and deal sourcing will need to be recognised, and reward matched to where the activities that built the brand have been carried out.

The transfer pricing used within fund structures (notably for any internal financing of property-owning companies) will also need to be considered, to validate compliance with this important new package of OECD guidance.

All of the OECD guidance described above form part of the new “post-BEPS” edition of the OECD Transfer Pricing Guidelines, published in July 2017. However, Real Estate fund managers should act on the basis that these measures in effect **already apply**, and in practice have been in place at least since FY2016. The number, and intensity, of transfer pricing challenges by increasingly well-resourced tax authorities will inevitably increase. This type of challenge is seldom based on a narrow construction of law, and tax examiners are likely to regard the new OECD guidance simply as explicit confirmation of what had historically always been a valid basis for making challenges.

Action 13 – Transfer pricing documentation, and CbCR

The BEPS measures

The post-BEPS version of the OECD Transfer Pricing Guidelines, noted above, are to specify a three-tier approach to transfer pricing documentation, as follows:

- A “master file”, containing information relevant for all group members.

- A "local file", covering all significant related party transaction flows involving the local group member.
- A Country-by-Country Report ("CbCR"), containing explicitly defined items of data on the global allocation of income and taxes, and certain other measures of economic activity. This is intended to be used as a risk assessment tool by tax authorities.

The CbCR rules are a "minimum standard", and all the 100 or more participants in the BEPS Project have committed to implement them without delay.

Obligations to then file the CbCR however apply only to multinational groups with a turnover above EUR 750 million. (The definition of a "group" in effect includes all entities that are covered by a single set of consolidated financial statements.) Where there is a filing obligation, the CbCR, showing data for all countries where a group has a taxable presence, must be then filed with the tax authority that has jurisdiction over the group parent.

This tax authority will then automatically exchange the entire CbCR data set with the tax authorities of all countries reported in the CbCR concerned. Strict taxpayer confidentiality measures are imposed, and this aspect was a major issue for both businesses and tax authorities during the evolution of the BEPS measures.

Indeed, the debate on this topic has continued since then, with vociferous pressure coming from some quarters for this confidentiality obligation to be overturned, and for there to be enforced publication of CbCR data by multinational groups. The controversy over this issue of "public CbCR" has been particularly intense at EU level. However, at present there is no clear agreement at EU level for there to be public CbCR, or any timeline for any public CbCR measures to take effect.

Timelines and EU action

Once again, the EU moved very quickly to seek to enforce the OECD recommendations, again with there being strong political pressure for action. Unanimous agreement was reached in early 2016 between all 28 Member States to further amend the EU Directive on Administrative Cooperation in the field of Tax, with these "DAC IV" changes being adopted into EU legislation in May 2016. These introduced procedures, based closely on the detailed OECD recommendations, for multinational groups above the EUR 750 million turnover limit set by the OECD to file CbCRs within 12 months of each relevant year end. For groups with calendar year ends, this obligation would begin with data for FY 2016 and a 31 December 2017 deadline for filing.

Luxembourg transposed the changes into its domestic law in December 2016, with the measures coming into effect on 1 January 2017, thus meeting the DAC IV deadline. Groups that were going to have to file CbCRs in Luxembourg had to notify the Luxembourg tax authorities in advance that they were "in scope", with the deadline for this finally having been set as 31 March 2017.

Most other EU Member States have done likewise. Indeed, globally by March 2017 57 countries had signed the Multilateral Competent Authority Agreement on CbCR and over 45 countries had CbCR legislation in place. Of all the components of the BEPS Project, these CbCR measures were always both the most likely to happen, and to happen soonest. This has certainly turned out to be the case.

The master file / local file methodology, and all the other Action 13 measures, form part of the "post-BEPS" edition of the OECD Transfer Pricing Guidelines published in July 2017, as noted above. There is a general expectation that FY 2017 transfer pricing documentation will need to comply with the new standard. Many countries treat the Guidelines as "soft law", and hence transfer pricing documentation that does not follow the revised Guidelines will potentially put its preparing company in difficulties, and possibly at risk of penalties in some jurisdictions, should a challenge to its transfer pricing be made.

Consequences for Real Estate funds and fund managers

The enhanced content requirements, and refined methodology, for preparing a **standard** package of transfer pricing **documentation** represent a notable **compliance challenge**, as the level of information newly required is substantial. This will affect both **all** Real Estate fund management groups themselves, and **all** fund structures that use internal debt financing or which recharge management costs to property-owning companies from other fund-owned entities.

Conversely, given the turnover requirement, **few** Real Estate **fund manager groups** outside the large financial institutions should themselves be **affected by** the new **CbCR filing obligations**.

Real Estate fund managers should have by now checked whether the CbCR rules will apply within any funds they manage. As noted, a review to confirm whether or not a fund is "in scope" should alreahave been a high priority, and if this was the case, reporting systems will need to be checked to ensure that they can generate the appropriate FY 2016 data.

Of course, the further issue for consideration then becomes assessing the consequences of the increased transparency to tax authorities of the data once reported.

Want to know more? Contact our experts

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