

## *Flash News*

### PwC Luxembourg BEPS Series- What it means for the Luxembourg Asset Management industry

9 October 2015

On Monday 5 October 2015, the Organisation for Economic Cooperation and Development (OECD) published its final package of reports on Base Erosion and Profit Shifting (BEPS) which was endorsed by the Finance ministers from the G20 group of countries during their meeting on 8 October 2015 in Lima.

For the mainstream Asset Management sector, the most relevant actions are those related to treaty relief for collective and non-collective investment vehicles, enhanced risk of permanent establishment regarding distribution and the shift in Transfer Pricing focus from contracts and risks to value creation and “significant people functions”. Even if these OECD recommendations remain subject to enactment in local legislations (which may take years), this is a climate change that the Asset Management industry should be carefully monitor and anticipate.

#### **Why the Asset Management industry should care about BEPS?**

The Asset Management industry has a cross-border activity by nature and as such BEPS becomes relevant from a product perspective (the fund) and from a corporate perspective (among others, management companies, distributors, sub advisors, etc.).

Because the OECD BEPS recommendations focus around 15 actions, it is clear that the Asset Management industry, as any other industry, will be somehow hit. Because BEPS is about taxes and taxes have a clear impact on investors' return and on the reputation of the asset managers, the later should keep an eye on the implementation of the BEPS recommendations

The main immediate impact of BEPS for mainstream Asset Management would be the following: (a) limitation to treaty access, (b) increasing risk of permanent establishment and (c) Transfer Pricing.

Other action points of BEPS could impact the mainstream Asset Management industry but to a lesser extent.

The alternative asset managers (Private Equity, Real Estate, Hedge Funds) may have a different perspective given the nature of their products and organisation.

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## What are the key relevant aspects of BEPS for the Asset Management?

### 1. Preventing Treaty abuse

The OECD has proposed three alternative approaches that countries could take to curb tax treaty shopping and other treaty abuses – a combination of Limitation On Benefits (**LOB**) rule and Principal purpose Test (**PPT**), PPT only, or LOB plus anti-conduit mechanism.

The proposed rules are detailed and complex and will have a particularly significant impact on both Collective Investment Vehicles (**CIV**) and non-Collective Investment Vehicles (**non-CIV**). Further work will continue in 2016 in a number of areas, including entitlement of non-CIV funds to treaty benefits.

The final paper provides for the ability of CIVs to qualify for treaty benefits and affords treaty partners with options as to how treaty access should be applied in this regard. The detailed version of the LOB clause outlines that whether CIVs are included as a specific category of qualified resident and whether any subsequent commentary regarding same is required will depend on how the model tax convention applies to CIVs and on the treatment and use of CIVs in each contracting state.

Regarding non-CIV funds (broadly alternative funds, Private Equity funds, SWF's) work will continue after 2015.

## 2. Artificial avoidance of the permanent establishment status

The outcome of the BEPS recommendations regarding permanent establishments is simply to more easily see a permanent establishment where there is not currently.

Without entering into all the technical details, practical impacts for Asset Management could be to have permanent establishments in certain countries just because of commercials visiting clients/investors. What is now seen as a representation office without any taxable presence may be seen as a taxable permanent establishment in a post BEPS world.

The areas of potential impacts are broad and will include the marketing and distribution aspects of funds as well as the delegation of management or advisory functions in various jurisdictions. As a result, a review of the existing distribution agreements and management or advisory agreements should be carried out in order to assess the potential impacts of BEPS.

## 3. Transfer pricing

A significant amount of the focus relates to aligning substance with the location of profits with a particular emphasis on the returns associated with risks, capital and intangibles. The key theme is the shift from legal form to people-based substance and value creation. For instance, where contracts appear to be inconsistent with conduct of parties the OECD BEPS recommendations could lead to the non-recognition of non-commercial transactions. It will be imperative for the asset managers to put a greater emphasis on the functions performed and on evidencing the location in which control of risks and intangibles is exercised using the new definitions.

Transfer pricing documentation will also be a challenge for the Asset Management industry with a requirement of having a master file containing information relevant for all group members and a local file referring to material transactions of the local taxpayer. Moreover, and subject to fulfillment of certain conditions (e.g. group with turnover above EUR 750m), a country-by-country report (**CbCR**) containing data on the global allocation of income and taxes, and certain other measures of economic activity will have to be prepared. This requirement may also apply to investment funds although some practical details need to be clarified.

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## When BEPS will come into play?

This is a difficult conclusion to draw from the BEPS reports and the result for the time being is absence of visibility on short and medium term as to how and to what extent domestic legislations will adopt BEPS. There are tools (e.g. a multilateral instrument) which can lead to quick changes for instance regarding the treaty access but they are not in place yet.

Direct application of the BEPS package itself will occur, whether in the shape of changes to tax treaties (through amendment of the OECD Model Tax treaty and/or the multilateral instrument) and the Transfer Pricing Guidelines or through changes to domestic legislation as a result of individual recommendations of the BEPS action points. The main immediate impact which is already lenient is the change of behaviors from the Tax Authorities.

The policy formulation stage of BEPS Action Plan will conclude at the end of this year, although it has been agreed that certain follow-on actions will take place during 2016 and beyond. The major focus of 2016 however will shift to the implementation and monitoring of the package.

Despite all the media comment, it is important to recognise that at this stage, the BEPS Project output is not law. Although many countries are beginning to implement some of the measures the BEPS Project has recommended, even now it is far from certain how far individual countries will go, and how quickly, to implement measures, especially those which are most likely to reduce tax competitiveness or tax revenues. We can however identify four different sorts of measures:

- **Minimum standards** to tackle issues – here there is an explicit commitment agreed to by all countries to consistent implementation (e.g. anti-treaty shopping measures, Country-by-Country Reporting transfer pricing documentation measures, the measures on harmful tax practices regarding e.g. the “modified nexus” rules for Intellectual Property regimes and automatic exchange of rulings and Advance Pricing Agreements by tax authorities);
- **Updated existing standards**, these being the OECD Transfer Pricing Guidelines, and parts of the Model Treaty Commentary;
- **Agreed general policy directions**, these being the BEPS recommendations on hybrid mismatches, and on interest deductibility; and
- **Guidance based on best practices** for instance on CFC rules, and taxpayer mandatory disclosures of aggressive or abusive transactions.

Asset Management players will need to consider not only the effects of how Luxembourg will transpose BEPS but also how all the other countries in which they operate or transact with will do.

There is a risk that domestic implementation can be unilateral and the desired international cohesion of the rules too little or broken. In the same time, countries will still clearly compete in providing business with an overall competitive environment, in which proportionality and practicality of BEPS implementation will play a very important role, all this while being shaped under the new principles.

**Get more information, contact your local PwC tax service provider or one of our experts**

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