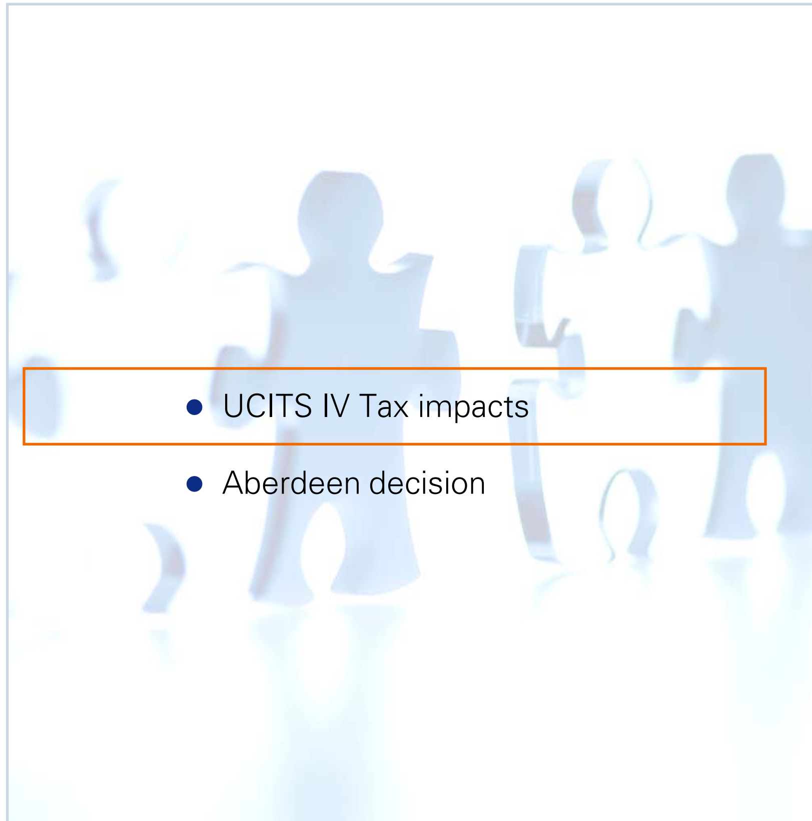
# UCITS IV Tax impacts Aberdeen decision

January 29, 2010

AUDIT ▪ TAX ▪ ADVISORY

# Agenda



- UCITS IV Tax impacts
- Aberdeen decision

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Overview*

- Tax references in the UCITS IV Bill have been withdrawn in the course of the adoption by the European Parliament.

- This may lead to implementation difficulties at the level of the Management Company, the Funds as well as the investors.

- Our tax analysis focuses on four crucial areas:
  - The cross-border merger of two or more EU-resident funds;
  - The management company passport and a cross-border fund structure;
  - The establishment of a cross-border Master-Feeder structure; and
  - Other matters outside UCITS IV: VAT and Double Tax Treaties

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Single Management Company: Issues*

⇨ **Historically:**

- UCITS funds were legally obliged to be managed by Management Companies located in the jurisdiction of the establishment of the fund.
- Alignment of the management of the fund and the supervision of the fund.

⇨ **Under UCITS IV:**

- Legal possibility of cross-border management
- This can happen through
  - Merger of multiple Management Companies into a single one, or
  - Relocation of the Management Company

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Single Management Company: Tax considerations (I)*

- **At the level of the Management Company:**
  - To realize a single management company, no particular taxation issues should arise if the merger directive applies.
  - In case of transfer of a Management Company's business, an exit tax obligation may arise (if no branch is set up in the former country).

- **At the level of the Fund**
  - Tax residency of the Fund:
    - In the case of corporate funds: The residency should not change,
    - If the fund has a contractual form or a unit trust: the residency of the Management Company may lead to a transfer of the tax residency of the fund.

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Single Management Company: Tax considerations (II)*

- Other tax considerations at the level of the Fund

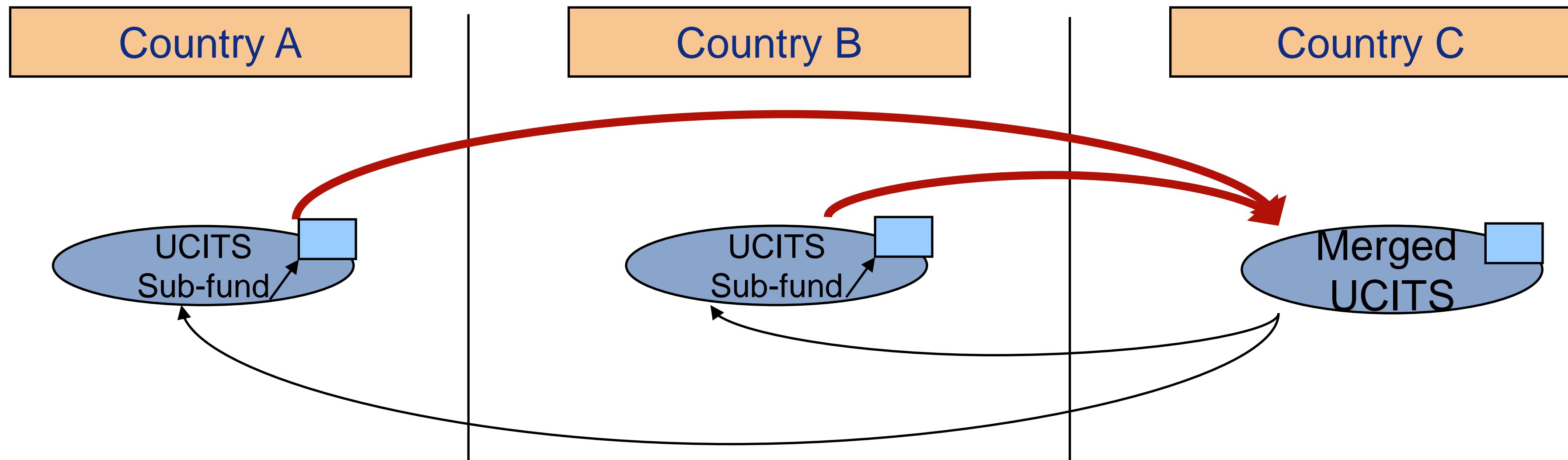
| | |
|---|---|
| **Liquidation** | Transfer may deemed to be a liquidation of the fund=Possible taxation of unrealized capital gains and disclosure of hidden reserves |
| **Double taxation / exemptions** | The jurisdictional separation of the Management Company and the fund could lead to double taxation at the fund level. |
| **Exemptions** | Risk of taxation of the fund's income in the Management Company's new country of residence at full rate. Exemptions, partial exemptions, or special low tax regimes are often restricted to domestic funds and are not available to foreign funds. |
| **Double Taxation Treaty** | The jurisdictional separation of the Management Company and the fund could alter the ability of the fund to access Double Taxation Treaties. |

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Cross-border merger: Issues*

- Under UCITS IV:
  - Cross border mergers is allowed from a legal and regulatory point of view. But the tax treatment of mergers of local funds varies from country to country.
  - Three types of funds are defined:
    - a contractual fund,
    - a corporate fund and
    - an investment trust.




© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Cross-border merger: Tax considerations (I)*

- Tax consideration:
  - **Tax neutrality**
    - Some countries allow tax neutrality,
    - Others will tax fund reorganizations.
  - **Tax discrimination** in relation to cross-border *fund reorganizations*
    - domestic a merger is tax neutral, while a cross-border one creates a taxable event
  - **Tax discrimination**, based on the *legal form of the funds*
    - No taxable events arise in some countries:
      - When fund reorganizations are limited to funds that have a specific legal form (e.g. incorporated funds).
    - Taxable event arise in case of contractual foreign fund reorganization:
      - When domestic law does not recognize the contractual form.

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Cross-border merger: Tax considerations (II)*

- Tax consideration linked to the compatibility  of the fund's legal structure:
  - **Two "Comparable" or "well-known" fund structures**
    - In principle no taxation should arise upon merger
  - **Non-comparable legal fund structures:**
    - Most tax laws are silent when it comes to reorganizations on a cross-border basis:
    - Tax neutrality is fully at the discretion of local tax authorities
    - Promoters are left with significant uncertainty.
    - A serious obstacle to the realization of an efficient single market for funds within the EU

➔A UCITS merger Directive for tax neutral fund reorganization would be of prime importance

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Master-Feeder Structure: Issues*

- Objectives of UCITS IV:
  - Create an environment that allows for the pooling of assets into a master fund.
  - Lower costs by developing economies of scale.

- Critical location issues:
  - Introducing the master-feeder concept ideally implies:
    - transforming existing domestic UCITS into local feeder funds and
    - transferring these assets into a newly created or existing master fund

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Master-Feeder Structure: Tax considerations (I)*

- **General Tax consequences:**
  - Setting up an inbound master-feeder structure with a local management company ➔ no negative tax consequences.
  - In a cross-border situation ➔ possible negative tax consequences

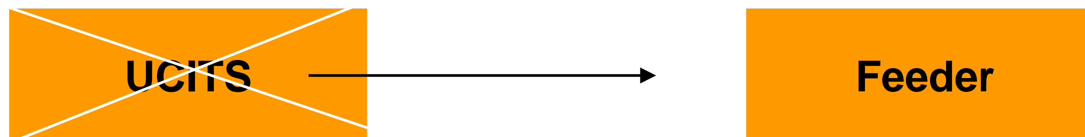
- **Taxation at the level of the Fund**
  - Levy of WHT on Master's profit distributions
    - Domestic master-feeder relationships: Generally no taxation and no withholding tax is due.
    - By contrast, in a Cross-border relationship risk of WHT
  - Redeeming units of the master
    - Specific capital gains tax provisions on the sale of substantial holdings in domestic companies by non-resident taxpayers
    - These rules are typically overridden by double tax treaties,
  - Countries taxing their investment funds at a much-reduced rate may go a step further and claim treaty protection for their investment funds.

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Master-Feeder Structure: Tax considerations (II)*

- **Taxation at the level of the investors**
  - Transformation of existing UCITS into feeder funds should be done at market value.
  - This could result in the taxation of gains not yet crystallized at the level of the investor
  - Roll-over provisions




© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Other matters outside UCITS IV: VAT*

- The key VAT issue at the level of the Management Company:
  - Risk that a merger of funds in some instances may result in the transfer of assets being subject to VAT.
  - Risk mitigation through careful planning of the merger as a VAT free transfer of a business as a going concern.
  - A VAT exemption may apply in the majority of cases where the transfer is within the scope of VAT.
- VAT distortions within the fund management sector include:
  - differences in the application of VAT exemption to fund management;
  - differences in the whether Member States consider a fund to be a "Taxable Person"; and
  - differences between Member States in their interpretation of what activities constitute fund management.

  ➔ The increase in the volume of cross border management services which will arise from UCITS IV will result in these VAT distortions obtaining a higher visibility.

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Other matters outside UCITS IV: Double Tax Treaties*

### Treaty Protection – Corporate funds

- **In some countries treaty benefits are granted based on:**
  - Tax treatment of the fund
  - Legal residence, and
  - Legal form of fund

- **Consequence:**
  - Some corporate funds liable to tax on their income are entitled to benefit from treaty protection
  - Luxembourg corporate funds, out of scope of income tax, are nevertheless treaty protected in a large number of cases based on legal residency.
  - French funds, incorporated or not, are not treaty entitled.

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Other matters outside UCITS IV: Double Tax Treaties*

**Treaty Protection – Contractual funds**

- **Contractual funds are generally considered fiscally transparent**
  - treaty between
    - the country where the investment lies and
    - the investor's country
  - should apply regardless of the management company's country of residence.

- **Exception:**
  - Where the contractual fund constitutes a taxable estate of its own (e.g. in Spain).
  - Residence = the country of the effective seat of management of the fund (i.e. residency of the management company).

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Key Tax Issues
## *Other matters outside UCITS IV: Double Tax Treaties*

### Treaty Protection – Protection of the Investor

- **Most important factor is**
  - the protection available to the investors of the fund
  - rather than the fund's domicile and legal form.
- **OECD's** recommend treaty protection be based on :
  - number of treaty-entitled investors involved,
  - rather than the status of the fund itself.
- **EU** could consider a similar approach
  - in the interest of UCITS investors,
  - regardless of residency technicalities faced by the fund.

  ➔ Proposed solution may in theory be a good fix, it would nevertheless appear difficult from a practical point of view.

KPMG

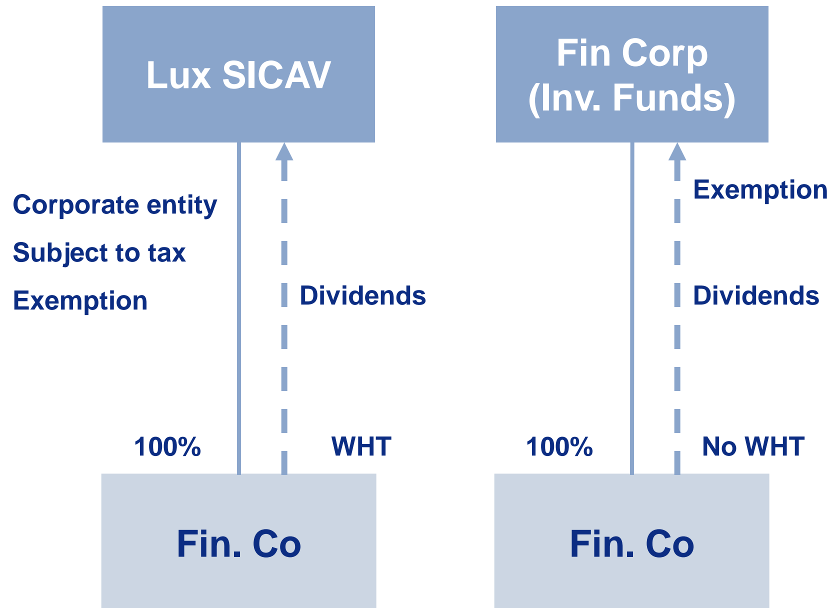
© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Agenda

- UCITS IV Tax impacts
- Aberdeen decision


© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Aberdeen Decision: Facts




## Finnish legislation background

- Prior to January 1, 2009, Finnish tax law exempts from WHT dividend payments to a Finnish corporation
- "Corporation" means a **share company**, cooperative, savings bank, **investment fund**, or any other legal person or a totality of assets reserved for a specific purpose comparable to those corporations.

⇒ WHT exemption on dividend payments to Finnish

- Limited liability company
- Investment fund

- Dividend payments to a foreign company however are subject to WHT
- Reduced rates or exemption of WHT may apply under EU Parent Subsidiary Directive and/or double tax treaties
- In Finnish law there is no company type identical to that of a SICAV

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# ECJ Decision

- **EU Parent Subsidiary Directive not applicable**
- **The freedom of establishment applies**
- **Restriction to freedom of establishment**
  - With respect to the taxation of dividends in the hands of the shareholders, the situations of resident and non resident shareholders are comparable
  - If a Member State chooses to eliminate the taxation of dividends in the hands of resident shareholders, it must applies the same treatment to non resident shareholders
- **Comparison Lux SICAV – Finnish company: restriction, regardless of:**
  - Legal form of a SICAV

    "the circumstance that in Finnish law there is no type of company with a legal form identical to that of a SICAV governed by Luxembourg law cannot in itself justify a difference in treatment, since, as the company law of the Member States has not been fully harmonized at Community level, that would deprive the freedom of establishment of all effectiveness."
  - Tax treatment of a SICAV

    "the circumstance (…) that the income of a SICAV is not taxed in Luxembourg, assuming that to be correct, does not create a difference between a SICAV and a resident share company which justifies different treatment"
  - Taxation at the level of SICAV's shareholders

    "there is no merit in the (…) argument that, because the Grand Duchy of Luxembourg does not tax the income of a SICAV, the imposition of a series of charges to tax takes place not at the level of the SICAV but at that of its members and should be avoided by the Member State in which those members reside."

  ⇨ **No comparison needed Lux SICAV – Finnish investment fund**
- **No justificatory ground applicable**

KPMG

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.

# Identifying viable claim territories

**The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.**

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is an affiliate of KPMG Europe LLP and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. Printed in Luxembourg.