Next Generation Fund Structuring – Are you ready?

10 May 2017
Global Private Equity Fundraising Activity
Agenda and Speakers

1. Fund Level Considerations
   - Adam Williams – EY Greater China Private Equity Tax Leader
   - Jacqueline Bennett – EY Asia-Pacific Wealth & Asset Management Tax Leader
   - Desmond Teo – Partner, International Tax Services, Ernst & Young Solutions LLP
   - Michelle Lloyd – Head of Irish Desk, Maples and Calder Hong Kong

2. OECD BEPS
   - Marlies de Ruiter – EY Global ITS Tax Policy Leader
   - Sara Yamotahari – Tax Market Leader, Pension & Sovereign Wealth Funds, Ernst & Young LLP

3. Regional Holding Companies
   - Adam Williams – EY Greater China Private Equity Tax Leader
   - Jacqueline Bennett – EY Asia-Pacific Wealth & Asset Management Tax Leader
   - Desmond Teo – Partner, International Tax Services, Ernst & Young Tax Solutions LLP
   - Jeroen van Mourik – Partner, International Tax Services, Ernst & Young Tax Services Limited

4. Case Study – Korea and US
   - Jeong Hun You – EY Korea Financial Services Tax Leader
   - Brandan Wing – Executive Director, International Tax Services, Ernst & Young Tax Services Limited
   - Aaron Lam – Executive Director, Global Compliance & Reporting, Ernst & Young Tax Services Limited

5. Closing / Conclusion
Fund Level Considerations
Fund Level Considerations

Factors to consider:
1. LP considerations
2. Physical location of operations
3. US tax reporting
4. AIFMD
5. Corporation V.S. Flow-through entity
6. Investee country considerations
# European Landscape

## At a glance: European NPPR landscape

<table>
<thead>
<tr>
<th>Article 42 status</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Article 42 implemented, Registration process straightforward (notification requirement)</td>
<td>UK, Netherlands, Luxembourg</td>
</tr>
<tr>
<td>Article 42 implemented, Registration process fairly straightforward (approval process)</td>
<td>Sweden, Finland, Belgium, Norway, Ireland, Iceland</td>
</tr>
<tr>
<td>Article 42 implemented, Registration process difficult, yet achievable (approval process and/or structural changes)</td>
<td>Germany, Denmark, Portugal, Slovak Republic</td>
</tr>
<tr>
<td>Article 42 implemented, Registration process difficult and hard to achieve (approval process and/or difficult evidentiary requirements)</td>
<td>France, Austria, Spain</td>
</tr>
<tr>
<td>Article 42 implemented, complexity of registration process not yet clear</td>
<td>Czech Republic, Hungary, Bulgaria, Estonia</td>
</tr>
<tr>
<td>Not possible (Article 42 not fully implemented)</td>
<td>Italy, Greece, Latvia, Lithuania, Liechtenstein, Slovenia, Croatia</td>
</tr>
<tr>
<td>AIFMD not implemented</td>
<td>Others</td>
</tr>
</tbody>
</table>

As at January 2017

Source: Maples and Calder
ICAV Distribution Potential: Parallel Funds

Source: Maples and Calder
ICAV Distribution Potential: Global Master-Feeder

Source: Maples and Calder
Summary of Proposed Framework of S-VACCs

**Investors level**
- Freely redeem shares and pay dividends out of capital
- Redemption of shares and capital reduction must be at NAV
- Not required to disclose its register of shareholders to the public

**Fund level**
- Governed by a new S-VACC Act
- Open-ended or closed-ended funds
- Umbrella funds / sub-funds with segregated assets and liabilities set up as separate “cells”
- Registered office in Singapore
- Min. one Singapore resident director and one director that is also a director of the fund manager
- Redomiciliation of similar entities from overseas will be permitted

**Fund Manager level**
- Managed by a licensed, regulated or a specified exempted fund management company

**Investors**
- Investment Management Agreement
  - Fund Sub-fund 1
  - Fund Sub-fund 2

**Target Investments**
Irish Collective Asset-Management Vehicle (ICAV)

<table>
<thead>
<tr>
<th>Key Features</th>
<th>P.L.C.</th>
<th>ICAV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Facility to “check the box” for partnership status for US tax purposes</td>
<td>☒</td>
<td>✔</td>
</tr>
<tr>
<td>Separate accounts for sub-funds</td>
<td>☒</td>
<td>✔</td>
</tr>
<tr>
<td>No statutory requirement to apply risk spreading</td>
<td>☒</td>
<td>✔</td>
</tr>
<tr>
<td>Facility to make (non-material) changes to constitutional document without investor approval</td>
<td>☒</td>
<td>✔</td>
</tr>
<tr>
<td>Not required to be incorporated with the Companies Registration Office</td>
<td>☒</td>
<td>✔</td>
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<tr>
<td>Facility to dispense with AGM in certain circumstances</td>
<td>☒</td>
<td>✔</td>
</tr>
<tr>
<td>Flexibility on type of accounting standards that may be used for financial statements</td>
<td>☒</td>
<td>✔</td>
</tr>
</tbody>
</table>

Source: Maples and Calder
BEPS Agenda

► BEPS Overview
► BEPS risk in a simple example: actions 2,4,6,7 and 13
► Implementation via Multilateral Convention
► BEPS Action 6 – Prevention of Treaty Abuse
► OECD Discussion Draft on non-CIV examples
BEPS Implementation: 15 Action Items

**Coherence**
- Hybrid mismatch arrangements (2)
- Controlled foreign company (CFC) rules (3)
- Interest deductions (4)
- Harmful tax practices (5)

**Substance**
- Preventing tax treaty abuse (6)
- Avoidance of permanent establishment status (7)
- Transfer pricing (TP): intangibles (8)
- TP: risk and capital (9)
- TP: high risk transactions (10)

**Transparency**
- Methodologies and data analysis (11)
- Disclosure rules (12)
- TP documentation (13)
- Dispute resolution (14)

**Digital economy (1)**

**Multilateral instrument (15)**

Changes to domestic legislation needed
Interpretation of existing treaty article
Peer review mechanisms
Changes to bilateral tax treaties needed
BEPS risk in a simple example: Actions 2, 4, 6 and 7

6 Anti-treaty abuse:
- Use of a conduit arrangement to obtain Treaty Benefit
- Beneficial ownership, LOB, GAAR, Treaty clearance, PPT

Regional Holding Company

Target Investments

Dividends/interest

Fund

Shareholder loan

2 Hybrid mismatch
Potential impact on hybrids

- Participation exemption
  - 100% exemption on capital gains, dividend income (subject to conditions)
  - Payment under hybrid instrument treated as dividend in recipient country and interest in payer country
- Back-to-back structure
  - Only limited spread taxable at this level (typically supported by APA/TP analysis)

4 Limit base erosion
- Earning stripping and thin capitalization rules, TP

7 Permanent Establishment
Taxable nexus as a result of activities in target country

- Participating exemption
  - Reduced WHT on dividend, interest payments and capital gains tax protection (subject to meeting requirements under the relevant tax treaty)
- Base erosion via interest payments
  - Generally subject to local country TP and SAAR rules
The intention of the MLC is to enable jurisdictions to implement treaty-related measures developed in the course of the work on BEPS, including the BEPS minimum standards.

It was developed in 2016 via negotiations involving around 100 jurisdictions.

According to the OECD, the MLC could lead to the application of 2,000 out of more than 3,000 treaties currently in force being amended.

Signature countries will provide a list of the tax treaties they have in force that they would like to be covered by the MLC (i.e. the Covered Tax Agreements).
Action 6 – Regional Investment Platform

Simplified prototypical PE structure

- Fund establishes Holdco for a variety of commercial purposes:
  - Legal liability
  - Governance
  - Third party financing

- Holdco is organized in Country A, a location that minimizes tax friction, including having an extensive treaty network

- Action 6 application to “Non-CIVs” calls into question whether structures like this should be viewed as treaty shopping
Example 1: Institutional investor regional investment platform

**Assumed facts**
- R Co formed as regional investment platform
- Purpose to generate investment returns
- Choice of R Co location:
  - Availability of skilled directors
  - Existence of a skilled workforce
  - Membership of a regional grouping
  - Membership of a common currency area
  - Access to beneficial treaty network

**Assumed functions of R Co**
- Experienced local management team to review investment recommendations
- Approve and monitor investments
- Manage treasury and back office functions

**Assumed purpose of Regional Investment Platform (R Co)**
- No other evidence of principal purpose being obtaining treaty benefits
OECD Model Tax Convention Guidance

Example 3: Real estate fund

Intra-group service contracts

Assumed facts
► Investment strategy based on asset yield and not tax position of investors
► Holdco provides liability protection for fund
► Holdco holds all the fund’s real estate assets
► Holdco provides debt and equity funding for investments
► Choice of R Co location
  ► Political stability
  ► Regulatory/legal framework
  ► Lender and investor familiarity
  ► Access to qualified personnel
  ► Access to beneficial treaty network

Assumed purpose of Holdco (State R)
► Simplification of administering withholding tax claims
► No treaty benefits over counterfactual of direct investment

Institutional Investors

Real Estate Fund (State C)

Holdco (State R)

Local Holdco

Local Bidco

Local Target
Regional Holding Company Considerations
The table below provides a ‘high level’ comparison of Luxembourg, the Netherlands, Ireland, Singapore and Hong Kong in relation to their suitability as a holding company jurisdiction.

<table>
<thead>
<tr>
<th>Key tax consideration</th>
<th>Luxembourg</th>
<th>Netherlands</th>
<th>Ireland</th>
<th>Singapore</th>
<th>Hong Kong</th>
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</thead>
<tbody>
<tr>
<td>Ongoing investment returns</td>
<td></td>
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<td>Shareholder debt</td>
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<td>Hybrid shareholder debt</td>
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<td>Shareholder debt margin</td>
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<td>Domestic exemption on distributions</td>
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<tr>
<td>Capital gains and exit</td>
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<tr>
<td>Taxation of capital gains</td>
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<tr>
<td>Frictional taxes on repatriation</td>
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<tr>
<td>Inbound WHT from source territories</td>
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<tr>
<td>Outbound WHT on interest</td>
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<tr>
<td>Outbound WHT on dividends</td>
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<tr>
<td>Other</td>
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</tr>
<tr>
<td>CFC</td>
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</tbody>
</table>
The Extended Offshore Funds Exemption Regime in HK

A recap of the original regime

1. Non-resident fund with central management and control exercised outside HK

2. Specified transactions (excluding private companies) and incidental transactions (not exceeding the 5% threshold); carried out through / arranged by specified person(s) only

3. Being a specified person (e.g. licensed by the SFC of HK)

4. Not carrying on any other business in HK

The fund is eligible for profits tax exemption if all conditions 1 to 4 are satisfied.

Legend:
- Engages for services, pays fees
- Provides services, receives fees
- Investment interest

Non-resident fund with central management and control exercised outside HK

Investors

Fund (non-HK)

Target Investments

Investment Manager (non-HK)

Investment Advisor (HK)

Outside HK

HK

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The fund is eligible for profits tax exemption if all conditions 1 to 4 are satisfied.
The Extended Offshore Funds Exemption Regime in HK

A glance of the key features

“Excepted private company” (“EPC”)

- Incorporated outside of HK
- To fulfil certain criteria within a 3-year look back period before a transaction in the portfolio company

Outside HK

PE Fund

SPV (HK / non-HK)

- Excepted private company
- Excepted private company

HK

Investment Manager / Advisor (HK)

- Investment Manager / Advisor do not have to be a “specified person” for “qualifying funds”

Holding through SPV (both in / outside HK) is allowable, HK tax exemption at the SPV level
The Extended Offshore Funds Exemption Regime in HK - Considerations

► Transfer Pricing
► Carried Interest
► How to apply the 10% test at EPC level
► Tainting effect
► Definition of SPV and Tax Residence
Case Study
Case Study

Investors

- US Investors 33.33%
- Asian Investors 33.34%
- EU Investors 33.33%

Fund Vehicle

Cayman Fund

Holding Jurisdiction

Netherlands

Target Jurisdiction

- Asia ex Korea
- Korea

- No US tax return filing requirements
- No US CFCs / s1248 concerns
- Potential US PFICs
- US long-term capital gains tax treatment on exit

- Korea beneficial ownership concerns
- Look through / OIV regime
- Korean Supreme Court cases
Case Study

Investors
- US Investors 33.33%
- Asian Investors 33.34%
- EU Investors 33.33%

Fund Vehicle
- Delaware Fund

Holding Jurisdiction
- Netherlands
  - 100%

Target Jurisdiction
- Asia ex Korea
- Korea
  - 80%

- Additional US tax return filing requirements
- US CFCs / s1248 concerns
- Korea beneficial ownership concerns
- Look through / OIV regime
- Korean Supreme Court cases
Case Study

Investors
- Asian Investors 50%
- EU Investors 50%
- US Investors 100%

Fund Vehicle
- Ireland Fund
  - 66.67%
- Delaware Fund
  - 33.33%

Holding Jurisdiction
- Netherlands
  - 80%

Target Jurisdiction
- Asia ex Korea
- Korea

- No US tax return filing requirements
- No US CFCs / s1248 concerns
- Potential US PFICs
- Tax transparency of the Irish Fund
- AIFMD considerations
- Proposed Dutch Co-op DWHT rules?
Case Study

Investors
- Asian Investors 50%
- EU Investors 50%
- US Investors 100%

Fund Vehicle
- Ireland Fund 66.67%
- Delaware Fund 33.33%

Holding Jurisdiction
- Singapore

Target Jurisdiction
- Asia ex Korea
- Korea

- No US tax return filing requirements
- No US CFCs / s1248 concerns
- Potential US PFICs
- Tax transparency of the Irish Fund
- AIFMD considerations
- Treaty protection?
Panel Members

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