



Global tax risk and governance functions for asset managers



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Increased compliance and reporting demands: Taxing authorities around the world continue to demand increased levels of compliance from alternative investment funds with respect to their investors, business operations and transactions. Several new developments are being implemented globally, such as the UK's Corporate Criminal Offence of Failure to Prevent the Facilitation of Tax Evasion legislation, withholding partnership rules, the Common Reporting Standard (CRS), the US Foreign Account Tax Compliance Act (FATCA), the EU Anti-Tax Avoidance Directive (ATAD), the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting Multilateral Instrument (OECD BEPS MLI), and the US Section 385 and Section 871(m) regulations.

Impacts: This increased focus on transparency has significant implications from both planning and compliance perspectives. Proactively addressing the necessary requirements will better position alternative investment funds from a competitive standpoint.

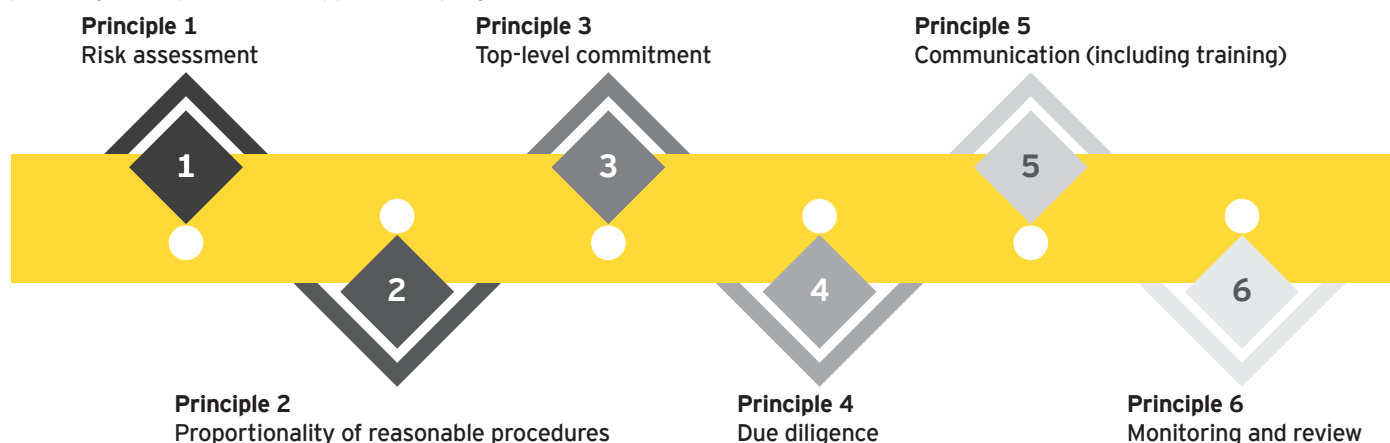
Next steps: From both compliance and reporting perspectives, fund managers will need to learn how to manage the volume of investor and transaction data, as well as be able to report this data to taxing authorities around the globe on an annual basis. Fund managers will need to review their current structures and policies to assess potential impacts and make certain that appropriate systems are put in place. Many of these new tax regulations require investment managers to have policies and procedures in place to document management's compliance efforts. Below, are examples of priority compliance initiatives for which prompt fund manager attention is recommended.

Issue	Potential impact	Actions	Deadline
UK's CCO	The new UK CCO legislation requires a business to have "reasonable preventive procedures" in place to prevent the facilitation of tax evasion by persons acting on its behalf (i.e., employees, contractors and agents). A fund manager may be subject to corporate criminal conviction if it cannot demonstrate that it had reasonable preventative procedures in place. A successful public prosecution could result in an unlimited fine, as determined by the court.	By September 2017, any fund manager trying to make certain that it has a defense of reasonable procedures should have identified, documented and categorized the potential risks of facilitation of tax evasion, identified the controls already in place to manage those risks, and devised a plan to address any control shortcomings or other necessary actions to address the risks identified.	Due by September 30, 2017
Withholding foreign partnership (WP)	Withholding partnerships must have a periodic review of their compliance covering one year of the three-year certification period or obtain a waiver from that requirement from the Internal Revenue Service (IRS). After any periodic review is complete, a withholding partnership's responsible officers must also make a certification to the IRS covering the entire three-year certification period. The certification requires the withholding partnership to verify that no material failure has occurred during the certification period, or it must disclose such a failure. If a material failure or event of default has not been corrected by the certification date, the withholding partnership must make a "qualified" certification and disclose the issue.	In advance of the periodic review, a withholding partnership should perform a health check to determine if there are areas that should be strengthened. A withholding partnership also will need to have a periodic review performed for one of the years in the certification period. The withholding partnership will need to remediate any material failures prior to certification.	Various, depends on effective date of withholding partnership's agreement with IRS The first certification deadline is July 2018 (for WP Agreements effective on or after June 30, 2014)
FATCA and CRS	FATCA and CRS requires that funds collect documentation, conduct diligence and report on their investors. Going forward, fund managers must have policies and procedures in place to make certain of compliance with FATCA and CRS. For CRS, many jurisdictions require written policies and procedures.	Fund managers should have governance frameworks in place for compliance with FATCA and CRS. Such frameworks should include written policies and procedures, training about changes in local guidance or internal policies, and periodic health checks to identify gaps that will need to be remediated.	Currently required, unless in jurisdiction that has not implemented FATCA or CRS

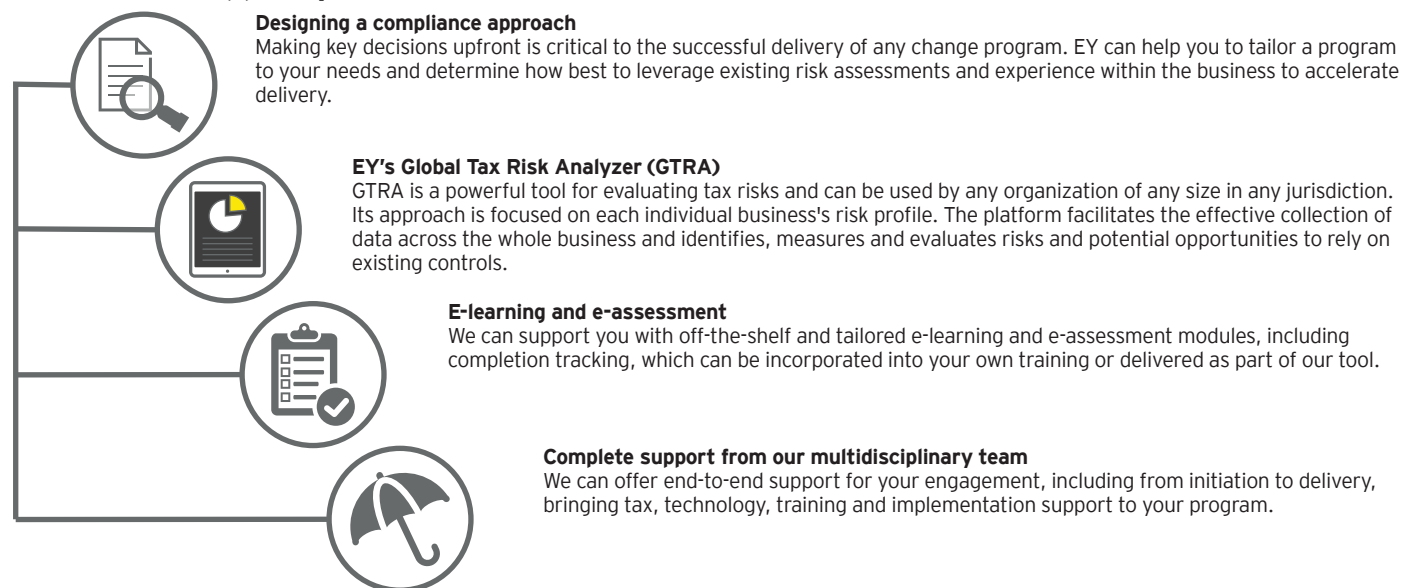
Issue	Potential impact	Actions	Deadline
Markets in Financial Instruments Directive (MiFID) II	MIFID II regulations require fund managers to separate payments for investment research from trading commissions. “Unbundled” research payments may potentially be subject to value-added tax (VAT). If the fund manager has no offsetting credits, these VAT payments will represent additional costs. In certain instances, the research payments may also be subject to sales and use tax in the US.	Review MIFID II-compliant research payment arrangements to identify potential VAT or sales and use tax impact.	Due by January 3, 2018
EU ATAD and OECD BEPS MLI	Investment platform holding vehicles (e.g., in Luxembourg, Ireland and the Netherlands) may be challenged, to the extent that they do not meet the limitation of benefits, principal purposes test (PPT) or similar anti-abuse provisions in the income tax treaty.	Consider consolidating investment holding platforms into a single jurisdiction where there is a greater operating substance footprint and presence of portfolio managers. Using the jurisdiction in which the international manager has an office as a holding platform may strengthen arguments that an income tax treaty PPT may not apply because it is likely to have significant substance.	PPT in force beginning January 1, 2019
Section 385 compliance	<p>The effect of the Section 385 regulations is to potentially re-characterize a debt instrument as equity, thereby eliminating the resulting US interest deduction.</p> <p>For alternative asset managers and funds, the two key provisions in the final regulations are:</p> <ol style="list-style-type: none"> 1. The Documentation Rule (Treas. Reg. Section 1.385-2), which establishes new contemporaneous documentation requirements that must be met for certain related-party debt to be respected as debt for US federal income tax purposes 2. The Recharacterization Rule (Treas. Reg. Sections 1.385-3 and -3T), which allow Treasury and the IRS to recharacterize certain related-party debt instruments issued in, or issued to fund, certain identified transactions as equity 	The Documentation Rule will continue to be in place for the foreseeable future. Alternative investment funds should develop the necessary systems and processes for compliance.	Contemporaneous documentation or analysis considered best practice and debt capacity and interest rate benchmarking analysis should be done before fund advanced; IRS notice extends effective date of documentation rule to apply to covered debt instrument issued or deemed issued on or after January 1, 2019, rather than January 1, 2018
Section 871(m)	<p>Section 871(m) treats “dividend equivalent amounts” arising on certain financial transactions that reference dividend-paying US equities as US-source dividends subject to withholding.</p> <p>IRS Notice 2017-42 extends the transition period for applying certain parts of the Section 871(m) rules. Delta-one transactions will continue to be treated as Section 871(m) trades for 2018, while trades with a delta between .08 and 1 will be in scope after December 31, 2018.</p>	Policies and procedures need to be reviewed to make certain of a “reasonable” effort to identify connected transactions and instances where transactions may fall outside of the relevant safe harbor rules (e.g., qualified index exception).	Currently, effective for delta-one transactions and effective for non-delta-one transactions January 1, 2019

Actionable steps

Determining what is reasonable is likely to be a key consideration for implementation of any new regulations, and will depend on the outcomes of the risk assessments and the risk appetite of the organization. EY has been actively supporting the wealth and asset management sector in developing industry-specific guidance to help clients determine a rightsized approach to their compliance and providing our experience to support their programs.



How EY can support you



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