

BEPS considerations for asset managers

The Organization for Economic Co-operation and Development (OECD) issued its *Action Plan on Base Erosion and Profit Shifting (BEPS)* in July 2013, setting forth the work that would be undertaken in 15 areas of international tax law and practice. Over the past six months, the OECD has issued discussion drafts on several of the action items, and the frequency and detail of these drafts continues to increase as the target completion dates in September and December 2015 approach. It is expected that final recommendations will be incorporated into the laws and procedures of individual countries and/or included in bilateral (or multilateral) treaties. This Alert focuses on the three action items that could have the most significant effect on asset managers.

Action 13 – Country-by-country reports (CBCR) and transfer-pricing documentation

The latest OECD guidance (6 February 2015) recommends filing the first CBCR for multinational corporation (MNC) groups for fiscal years beginning on or after 1 January 2016, with the first filing due by 31 December 2017 (for companies operating on a calendar year-end). Prior guidance from the OECD outlined the CBCR template requiring MNC groups to report the amount of revenue (related and unrelated party), profits, income taxes paid and taxes accrued, employees, stated capital and retained earnings, and tangible assets annually for each tax jurisdiction in which they do business. The latest guidance recommends establishing a mechanism for government-to-government exchange whereby an MNC would file the CBCR template in the jurisdiction of its parent entity, which would then be automatically shared with other jurisdictions in which the MNC operates (assuming each jurisdiction satisfies the necessary conditions with respect to confidentiality, consistency and appropriate use). Governments are expected to use the information to conduct high-level, transfer-pricing risk assessments. The OECD guidance also recommends implementing the master file and local file elements of the new transfer pricing documentation standard through local country legislation or

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administrative procedures and filing them directly with the tax administration in each relevant jurisdiction, as required by those administrations. With the UK formally committing to CBCR implementation and officials at the US Treasury Department describing it as “a virtual certainty,” CBCR is the most imminent action item facing the asset management industry. It should be noted, however, that each country will need to pass legislation, issue specific regulations or adopt new filing requirements to implement the OECD’s recommendations on CBCR. The OECD has recommended an exemption for MNC groups with annual consolidated group revenue of less than €750m in the prior year (Threshold Revenue) in respect of CBCR. How this exemption would be implemented for global management companies (including whether, in the case of US-based asset managers, incentive allocations and carried interest received by an affiliate entity would be aggregated with a management company’s revenue stream in determining the Threshold Revenue) remains an open question.

Evaluate operations this year

While precise timing and details of country-specific CBCR rules are not yet clear, meeting the requirements of CBCR will likely be administratively burdensome; thus, asset managers should prepare as early as possible and evaluate their existing operations vis-à-vis some of the following considerations:

▶ **Management companies (or affiliates) in low-tax jurisdictions:**

To the extent a mismatch exists on the CBCR template (e.g., between revenue or income tax paid when compared with full-time employees), these entities may be subject to increased scrutiny when multiple jurisdictions review information on an asset manager’s global operations, as reported on the CBCR template. Therefore, critical points to consider include ensuring sufficient documentation exists to support the remuneration flowing into a jurisdiction as representative of arm’s-length pricing.

▶ **Related-party financing:**

Structures involving financing from related-party lenders are likely to face increasing scrutiny upon review of related-party and unrelated-party revenue against income tax reported on the CBCR template.

▶ **Common structures/entities:**

These would include US subsidiaries of non-US funds and European investment subsidiaries of low-tax jurisdiction fund entities. The review of CBCR information may generate more inquiry from local tax authorities relating to revenue, expense and taxable income figures. Therefore, transfer-pricing documentation should provide specific details on asset managers’ global value chains to provide clarity and support for results observed in the CBCR.

Update and/or improve existing transfer-pricing analysis and documentation

Action 13 requires the preparation of the CBCR template, a transfer-pricing master file and local country files. A thorough review and update of existing documentation is critical to creating a unified, commercially justifiable and global arm’s-length picture. Special attention must be made to prepare the master file, which will detail the global value chain.

Action 6 – Preventing treaty abuse

Action 6 recommends that a country adopt either a US-style limitation on benefits (LOB) provision or a Principal Purpose (of tax avoidance) Test (PPT) provision in its bilateral treaties. There is no mandated time frame for the inclusion of the LOB or PPT language into the bilateral treaties of OECD members, and this process is likely to take an extended period, perhaps as much as 5-10 years. This time frame, could however, potentially be shortened significantly, pending implementation of the OECD’s proposed multilateral instrument. This recommendation has generated significant commentary from the investment fund industry as it relates to treaty access by collective investment vehicles (CIVs) and non-CIVs (i.e., alternative funds). The OECD has begun to address exemptions for CIVs. Non-CIVs face much greater uncertainty. Several commentators have

expressed the importance of tax neutrality and treating investors the same whether they invested directly or through a CIV or non-CIV fund. Commentators have also noted that the fund industry would have difficulty in meeting either test and noted the issue of subjectivity of the PPT test. Views, however, have differed on how or whether to modify these provisions. The OECD working group will meet in March 2015 and a revised discussion draft will be released in the spring when stakeholders will have another opportunity to submit comments.

Evaluate existing treaty benefits and quantify risk of treaty changes

Asset managers should carefully monitor Action 6 and review the treaties from which they

are currently benefiting. Asset managers should then quantify the amounts at risk to the extent that Action 6 is implemented in the applicable treaty countries and plan for possible restructuring in the medium and long terms.

Action 2 – Hybrid mismatch arrangements

Action 2 is aimed at the use of hybrid entities and hybrid instruments (including repurchase agreements and securities loans) when, for example, there is a deduction that reduces taxable income in one jurisdiction and those amounts flow into another jurisdiction untaxed. Thus, in order to eliminate potential double non-taxation, the recommendations under Action 2 are for legislation or modified treaties that would

limit any cross-jurisdictional benefit for hybrid entities and hybrid instruments.

Evaluate existing use of hybrids and quantify risk of domestic law and/or treaty changes

Asset managers should review their operations and investments to: (i) identify all hybrid entities and hybrid instruments, (ii) quantify any existing tax benefits and the potential loss of those benefits if the law were to change, and (iii) evaluate the need for restructuring in the medium and long terms.

Next steps

This Alert has focused on the three action items most relevant to the asset management industry. Further guidance will be shared as developments unfold.

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