Keeping up with Tax – Asset and Wealth Management

May 2020

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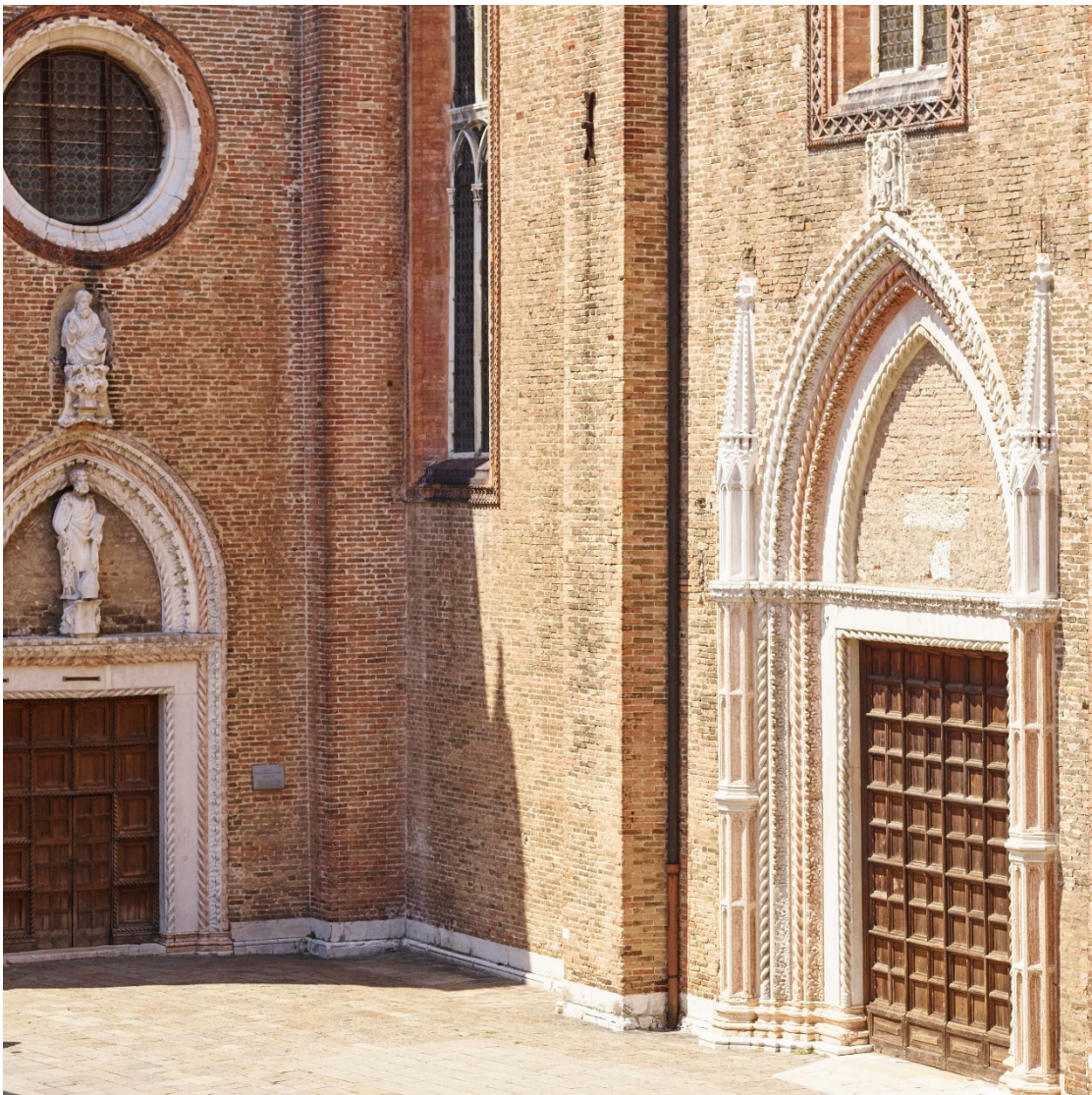

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Introduction

Welcome to our May edition of Keeping up with Tax – Asset and Wealth Management. As we find ourselves in the same extraordinary circumstances as we did at the time of our last edition, we hope, first and foremost, that you and your loved ones remain safe and well during what continues to be a worrying time for all of us. While we might be becoming more accustomed to working remotely, and it remains likely that we will continue to do so for some time to come, the challenges of doing so have not necessarily gone away and we are all undoubtedly continuing to adjust to the challenges COVID-19 has presented to us in this respect. Our dedicated COVID-19 web page continues to be updated regularly with the latest guidance, updates, and details of how we can offer help and support to businesses, from crisis scenario planning, to cashflow management and cyber security.

The current crisis also dominated the results of our Q1 2020 PwC and Confederation of British Industry ('CBI') Financial Services Survey which we released in April. Unsurprisingly, the results underline the extraordinary challenges facing the sector and its clients, and drew out the emphasis being placed on asset and wealth managers ('AWMs') trying to move back to something resembling business as usual, and the necessity of operational resilience in the current climate. You can see a summary of the results here, which include figures specific to the asset and wealth management ('AWM') sector and can download the full results here.

On to tax matters, and as you will be aware, the tax system has been a key tool which Governments across the globe have tried to harness to support businesses through the current crisis. In the UK, VAT deferrals are one of a number of methods through which businesses are being supported through any cash flow difficulties they might be facing. We have a full article in this edition on VAT support being offered by HMRC during the crisis, as well as the news that the deadline for the implementation of Making Tax Digital has been deferred. On direct tax issues, the OECD has released their guidance on the impact of COVID-19 on corporate residence and permanent establishment issues. Following this, in the UK HMRC has also released its own guidance with a number of clarifications on activities and changes which could impact an entity's tax status. We have also included an article on this guidance with details.

While AWMs will no doubt be welcoming certain requirements being relaxed and the cash flow assistance being offered by Governments, it will be important over the coming months not to lose sight of a number of requirements which, at the date of publication at least, have not been pushed back at all. Most notable amongst these is the implementation of the EU Mandatory Disclosure Rules in under two months on 1 July 2020. There have been a number of useful updates and clarifications from HMRC since the new year, and we have collated these into an article summarising HMRC's current position on a number of the hallmarks and the concrete requirements. While a delay to implementation is not impossible, it is now of critical importance that AWMs are prepared for the rules to kick in on 1 July as this remains the most likely scenario.

We have a packed edition this month covering a number of the most pressing issues for AWMs to be thinking about and acting upon, including:

- UK – HMRC and OECD guidance on PE and residence in light of COVID-19
- UK – Making Tax Digital deferred and COVID-19 support for VAT
- Europe – The corporate governance and tax documentation challenges of COVID-19
- UK – HMRC guidance for EU Mandatory Disclosure Rules
- Luxembourg – Potential non-deductibility for EU blacklisted countries
- Europe – European investor reporting challenges under COVID-19
- UK – CRS Reportable Jurisdictions and Excluded Accounts

As always, please share your feedback with us, and please do get in touch with any of the contacts listed, or your usual PwC contact, if you would like to discuss any of the topics further.

Kind regards,

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UK – HMRC and OECD guidance on PE and residence in light of COVID-19 (1/2)

On account of travel restrictions imposed by national governments or quarantine requirements, there are business concerns that workers may be present in a jurisdiction long enough to trigger a permanent establishment ('PE') or residence rules under applicable tax treaties (or similar instruments). On 3 April 2020, the OECD Secretariat released initial analysis on tax issues arising from cross- border workers affected by the COVID-19 crisis. The focus of the OECD guidance is the extent to which companies might face concerns around creating new PEs or residence issues due to the temporary displacement of staff or managing officials.

Some countries such as the United Kingdom, Australia, Ireland, US and Singapore have also published their own guidance. Some of these country specific guidance reflect the position adopted by OECD while some countries have provided additional guidance on corporate residence and PE issues.

The above guidance provided by OECD and various tax authorities can be accessed on PwC's COVID-19 site here.

Snapshot of guidance across the globe

OECD

In general, the OECD secretariat cautions that the 'exceptional and temporary' impact of COVID-19 crisis on employee displacement should not create changes to PE determination under most current tax treaties. Based on an analysis of existing treaties, the Secretariat stated that generally working from home or concluding contracts from an employee/agent's home under exceptional and more importantly temporary situations should generally not be sufficient to create a PE. That said, they noted it was important to consider what other activity might be occurring in the territory which could change this position.

Regarding interaction with 'place of effective management' in corporate residency determination, the OECD secretariat noted that temporary changes in location of CEOs and other senior executives due to COVID-19 should not trigger a residency change, especially after applying the tax treaty tie-breaker rules.

United Kingdom (UK)

In the UK, HMRC's guidance indicates that a change in the worker location over a short period should not necessarily affect corporate residence and PE position. The guidance also stresses that HMRC will take a holistic view, considering all facts and circumstances. This approach seems to align with the OECD guidance.

HMRC addresses the issues of corporate residence and PE as follows:

- Corporate residence: a company will not necessarily become resident in the UK because several board meetings are held here, or because some decisions are taken in the UK over a short time period.

- Permanent establishment: a non-resident company will not automatically have a taxable presence by way of PE after a short period of time. Similarly, whilst habitual conclusion of contracts in the UK would also create a UK taxable presence, it is a matter of fact and degree as to whether the habitual condition is met.

Australia, Ireland, Singapore and US

Australia also addressed the issue of corporate residency and PE issues in posted FAQs. The Australian Tax Office (ATO) stated that a non-tax resident forced to hold board meetings in Australia due to COVID-19 (or board members attending meetings from Australia) should not alter a company's residency. Similarly, the ATO stated that for a company without PE in Australia, the presence of company employees within the country due to travel restrictions arising from COVID-19 should not, by itself, change PE status.

Ireland issued a bulletin with similar advice that the presence of company employees generally would be disregarded for corporate tax purposes where arising from travel restrictions related to COVID-19.

Singapore has also issued guidance similar to the ATO FAQs wherein a Singapore company's inability to hold Board of Directors (BoD) meetings in Singapore, or a non resident company holding its BoD meeting in Singapore, will not automatically lead to challenge to the residency status. Also, where employees of a foreign company may have to remain in Singapore due to travel restrictions relating to COVID-19, Singapore will not necessarily consider such unplanned presence as creation of a permanent establishment in Singapore for the foreign company. That said, the Singaporean Tax Authorities have placed some restrictions on the applicability of the guidance.

UK – HMRC and OECD guidance on PE and residence in light of COVID-19 (2/2)

The US has issued Q&As that state that foreign companies can elect a period of 60 days starting between 1 February and 1 April during which services or other activities performed by one or more non-US residents temporarily present in the US will not be taken into account to determine whether the non-resident or foreign corporation has a PE or a US trade or business, provided that the services or other activities of these individuals would not have occurred in the US but for COVID-19 Emergency Travel Disruptions.

Observations on the UK approach

Company Residence

Occasional UK board meetings, or participation in such meetings from the UK, does not necessarily result in Central Management and Control (CMC) in the UK.

Where a Double Tax Treaty is in existence, even if UK CMC were established, the appropriate test becomes either Place of Effective Management (POEM), which can only be in one jurisdiction such that short term UK CMC is unlikely to tip the balance, or Competent Authority which requires consideration of POEM and other factors.

Whilst not covered in HMRC's guidance, for non-UK incorporated companies that are UK resident by virtue of CMC in the UK, a similar logic should apply. That is, HMRC would probably not take the position that occasional non-UK board meetings, or participation in such meetings from outside the UK, changes the residency position in and of itself.

UK PEs

HMRC believe that current legislation, treaties and related guidance provide sufficient flexibility with regard to whether a PE has been created in the UK.

HMRC consider a non resident company will not have a UK fixed place of business PE after a short period of time as a degree of permanence is required.

Whilst the habitual conclusion of contracts in the UK would also create a Dependant Agent PE in the UK, this is a matter of fact and degree.

The existence of a UK PE does not in itself mean that a significant element of the profits of the non-resident company would be taxable in the UK.

The guidance does not change the rules to be applied in the UK, nor offer a safe harbour for this period (as we have seen in other states - Australia, Ireland and Singapore). Instead HMRC are emphasising that temporary arrangements resulting from the COVID-19 crisis are unlikely on their own to change residence or give rise to PEs.

Next steps for asset and wealth managers

Whilst HMRC have said that temporary arrangements resulting from the COVID-19 crisis are unlikely on their own to change residence or give rise to PEs, businesses should continue to monitor current operating models. This applies both in the context of existing transfer pricing arrangements and in considering whether the COVID-19 resulting activity in the state might create a PE in combination with activity already in the state.

It will be important to understand where key value driving functions are being performed, and to assess whether this is in line with the functional profile on which the transfer pricing policy is based. If current transfer pricing policies are based on the location of key decisions (e.g. taken by the Investment Committee or other senior members of the business) and those decisions are now being made in a different location than normal, the potential impact on transfer pricing arrangements will need to be considered.

In addition to monitoring any impacts on the actual transfer pricing policies arising from the potential displacement of staff, careful consideration should also be given to any potential impacts to VAT positions, personal and employment tax consequences, or the regulatory position of the group.

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UK – Making Tax Digital deferred and COVID-19 support for VAT (1/2)

COVID-19: Deferral of VAT payments due

On 20 March the Chancellor announced that any business with a VAT payment falling due between 20 March and 30 June would be permitted to defer this payment. This is to support businesses with liquidity in acknowledgement of the difficulties many businesses are facing as a consequence of COVID-19.

Payments can be deferred until no later than 31 March 2021, and no interest nor penalties will be charged by HMRC on any amount deferred under these measures. It is important though for businesses availing themselves of this payment deferral to continue to file VAT returns in accordance with their normal schedule, via Making Tax Digital online submission, where appropriate. However, they do not need to pay HMRC. There is no application nor notification to HMRC required for this.

Deferral is available for VAT return payments and also for any payments on account due in this period.

These measures are unprecedented and demonstrate the UK Government's commitment to tackling the economic difficulty many businesses will face. All businesses that have, or will have, a payment (or payments) of VAT falling due in the period 20 March 2020 to 30 June 2020 should therefore fully consider whether this deferral could assist their business in these uncertain economic conditions.

For those businesses that wish to take advantage of the payment deferral, but who normally make payments to HMRC via Direct Debits, it will be necessary to cancel their Direct Debit, as otherwise HMRC will automatically request payment. There is no automatic deferral of Direct Debit payment. It can take around 5 day to cancel a Direct Debit instruction.

For businesses in a refund position, this deferral will not create a benefit. For such businesses, it is possible to request a move to monthly VAT returns, which can accelerate the refunds and assist with liquidity. Such businesses should be aware that there will be additional administrative time required to prepare and file returns on a monthly basis.

COVID-19: Lease renegotiations and VAT consequences

One of the other measures introduced by the Government in response to COVID is a new rule to prevent landlords from evicting commercial tenants for a 3-month period.

Certain tenants are looking at ways to manage their cashflow position during this period and also going forward. We have already seen discussions taking place between landlords (including real estate funds) and tenants on a number of solutions and many of them could have an impact on VAT, potentially negative.

Areas which we see as particularly problematic are:

- Terminations
- Discussions on rent holidays, reduced rents or rent deferral.
- Subletting and assignments - Looking to actively assign leases or sub-let to third parties, due to concern over vacancies
- Repurposing (e.g. using empty student accommodation for other purposes)

If you are the landlord holding such discussions, or a landlord that is seeking to change an intention regarding an untenanted property, it is important to consider at an early stage how any such changes could affect the VAT treatment (including any impact upon historical VAT accounting), such that these can be managed, and/or included in the commercial considerations.

COVID-19: Other jurisdictions

In response to COVID-19, many countries around the world are implementing emergency tax measures to support their economies. PwC is maintaining a summary of the international COVID-19 VAT/indirect tax related developments at the following website. This source is regularly updated.

Measures being implemented in other jurisdictions include delayed VAT payments to allow businesses a cashflow benefit, or cuts in VAT/ GST rates to help the worst affected sectors, such as consumer, tourism/hospitality, or in respect of medical supplies.

We summarise below a couple of example countries to illustrate the PwC COVID-19 website content:

In Germany, the German Federal Ministry of Finance has issued a decree announcing tax measures in light of COVID-19. This decree deals with deferral and enforcement measures and the adjustment of advance payments. The decree is applicable for most taxes levied in Germany including, but not limited to, income tax and corporation tax and VAT.

UK – Making Tax Digital deferred and COVID-19 support for VAT (2/2)

For VAT purposes specifically, however, the measures are limited to taxable persons "directly" affected by the effects of the COVID-19 pandemic. It is also necessary that a taxable person is affected "to a considerable extent".Upon application (and if these conditions are met), deferment for VAT for which the taxable person has become liable, or will become liable, can be granted upon application until 31 December 2020.

As the German Federal Ministry of Finance makes clear, no strict requirements are to be set when reviewing the conditions for deferral. For VAT that becomes liable after 31 December 2020, the application must be substantiated in detail. Please note that an application for deferral should be filed in time, to avoid overstepping of time limits for payment and possible penalties for late payment. The decree also deals with a possible suspension of enforcement measures until 31 December 2020 as well as of the waiver of penalties for late payment.

In the Netherlands, the Dutch tax authorities have announced the possibility of an extension of the payment deadlines for various taxes, including VAT. This was announced as part of an emergency measures package on 17 March 2020.

The request needs to be submitted in writing and should contain an explanation why the COVID-19 has impacted your company, as well as a declaration from a third party to ascertain the viability of your company.

The measures also included late payment interest for VAT being temporarily reduced from 4% to 0.01%. Penalties for not paying VAT due on time will also be waived.

HMRC has announced that the deadline for the implementation of digital links per Making Tax Digital ('MTD') has been delayed in acknowledgement again of the difficult position many businesses are in. These requirements will now come into effect for VAT periods commencing on or after 1 April 2021. This means that both the 1 April 2020 and 1 October 2020 MTD deadlines are now merged and moved to 1 April 2021.

The ability to get a specific direction from HMRC on a deferral beyond the MTD deadline, now 1 April 2021, will still be possible. In addition, where a business already has a deferral in place that extends beyond 1 April 2021, this agreement will remain extant.

These MTD deferrals will clearly assist many businesses who have many other pressing issues to deal with at this time. However, whilst the deferral is likely to be generally welcome, HMRC remains committed to seeking a more digitally enabled future, and MTD is a key objective of this initiative. It is therefore important for businesses to remain focused on MTD and ensure that they comply with the new extended deadline.

Making Tax Digital – deferral

Next steps for asset and wealth managers

It is important that asset and wealth managers understand the various deferrals and benefits being offered by HMRC and other tax authorities to taxpayers through the VAT system in order to ensure that they are in a position to make use of what is being offered to the extent appropriate.

With regard to the deferral of MTD until 1 April 2021, additional time is helpful, but AWMs will need to ensure they do not leave themselves in a position where they are playing catch up as the revised deadline approaches next year.

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Europe – The corporate governance and tax documentation challenges of COVID-19 (1/2)

This article includes key regulatory guidelines and PwC insights for funds located in the United Kingdom, Ireland and Luxembourg considering legal and governance issues focusing on conducting Annual General Meetings ('AGMs'), holding board meetings, complying with Market Abuse Regulations ('MAR') and with Disclosure, Guidance and Transparency Rules ('DTR') requirements, and document execution. This article mainly discusses listed funds, however it highlights areas related to unlisted funds and legal entities, where necessary.

Annual general meetings

Companies which have a 31 December year-end are now entering the AGM season and are having to grapple with whether to postpone, or hold completely virtual AGMs – As well as how best to engage with their shareholders. Across the three jurisdictions, legislation has been introduced to assist companies with their AGM contingency planning, as follows:

- UK: Funds that are listed in the UK will be covered by emergency legislation introduced to allow companies to hold completely virtual AGMs, or to postpone the meeting altogether, even if the articles say otherwise.
- Ireland: The Irish Law Society has 'recommended' that companies dispense with holding physical AGMs during the lockdown period, and has stated that subject to certain conditions, AGMs can be held outside of the state with members participating electronically.
- Luxembourg Similarly to Ireland, any company type (including unlisted and portfolio companies) can hold a general meeting without anyone present, as per the Grand-Ducal Regulations of 20th March 2020 which prevails over the company's articles.

Board meetings

Regarding board meetings, the three jurisdictions have a fairly similar approach:

- UK: For UK-listed funds, unlisted funds and legal entities, board meetings can be held electronically, provided the articles do not expressly rule against this.
- Ireland: The Business Law Committee has likewise recommended that board meetings be held via electronic means or by way of a unanimous written resolution (which should be signed by all board directors).
- Luxembourg: The Grand-Ducal Regulation has permitted that even if the articles forbid it, board meetings can be held via electronic means.

Market Abuse Regulations/Disclosure, Guidance and Transparency Rules

Turning to MAR and DTR, regulatory guidance differs between each country, and will be discussed in turn below.

UK

Whilst the majority of the obligations remain unchanged (e.g. MAR obligations), the Financial Conduct Authority ('FCA') has provided temporary relief in certain areas (as outlined below) to the extent the funds and firms are unable to comply with their obligations as a result of COVID-19:

- For UK Undertakings for the Collective Investment in Transferable Securities ('UCITS') and non-UCITS retail schemes, publication of annual financial statements and value assessments can be delayed by two months; and half yearly statements by one month.
- Until 1 October 2020, Markets in Financial Instruments Directive ('MiFID') 10% rule waiver applies, provided the firm: has issued at least one 10% depreciation report to retail clients within a current reporting period; and subsequently provides general updates; or can cease providing 10% depreciation reports for any professional clients.
- Filing deadlines for RTS27, RTS28 and Article 65(6) (reports in regard to best execution under MiFID II published by execution venues and firms respectively).
- Dividend payments can be deferred for 30 days.
- The FCA has also announced measures aimed at assisting companies to raise new share capital (e.g. using short form prospectus) and on working capital statements.

Europe – The corporate governance and tax documentation challenges of COVID-19 (2/2)

Ireland

For authorised investment funds, the following audited financial statements can be delayed as follows:

- annual audited financial statements that correspond to a year end on or after 31/12/2019 but before 1/4/2020 can be delayed by two months; and
- annual audited financial statements referring to a year end
  - on or after 1/4/2020 but before 1/5/2020; or
  - on or after 31/1/2020 but before 1/4/2020 can be delayed by one month.

For investment firms, filing of following accounts and returns can be delayed as follows: Annual audited accounts, data entry/annual audited accounts upload and related party annual accounts upload relating to submissions falling due from April to July 2020 inclusive can be delayed by two months; and

- Management/interim accounts, management accounts, budget vs actual and certain capital adequacy return types referring to reporting dates March to May 2020 can be delayed by one month.

Luxembourg

- Issuers have been warned to take 'particular care' of their disclosure obligations under MAR, and ensure to take into consideration Commission de Surveillance du Secteur Financier ('CSSF's) IT security recommendations made in its COVID-19 FAQ.
- For Lux SICARs, SIFs, RAIFs and Part II UCIs, the deadline for publishing annual reports and half yearly reports (where applicable) has been extended for a period of three months, provided the deadlines for the reports have not expired on 18 March 2020 and the reports relate to a period closed before the date on which the pandemic ends. CSSF can extend, for a period of up to three months, the deadlines in respect of the drawing up and the publication of any other periodic reports provided for in the laws it enforces.
- CSSF has granted reporting extensions to certain entities.
- Finally, the surcharge for the late filing of accounts has been lifted for an additional four months.

Document execution

Electronic signatures are generally accepted across the three jurisdictions, with a couple of nuances:

- UK: E-signatures are typically considered valid, and types of execution can include email confirmation, signing through an application such as Docusign or Adobe, or simply scanning a wet ink signature for use in documents.
- Ireland: E-signatures are unlikely to be permitted for documents that are required to be executed under the seal.
- Luxembourg: E-signatures cannot be used for contracts creating or transferring rights on real property, contracts requiring intervention by tribunals, or public authorities.

Next steps for asset and wealth managers

COVID-19 is a rapidly changing circumstance and companies will need to take extra care in order to ensure they fulfil their legal and regulatory obligations as they change on a day-to-day basis over the coming months.

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UK – HMRC guidance for EU Mandatory Disclosure Rules (1/2)

On 13 January 2020, final regulations to implement EU Directive 2018/822 ('DAC6') on the mandatory disclosure and exchange of cross-border arrangements were laid before Parliament and became law. Draft guidance was published in March 2020 for further consultation, which we explore further in this article.

It appears that HMRC would like EU MDR to be applied in the UK in a **pragmatic** and **targeted** way, and in general the draft guidance reflects this intention. However if AWMs have reporting obligations in other EU countries, AWMs will need to consider the regulations and guidance in those countries, which may well be different from the UK

The rules are very important for AWMs and their Funds who themselves may be intermediaries with reporting obligations.

By way of a reminder, the regime has been 'live' since June 2018, although we are in a transitional period with the first reporting for the period from June 2018 to July 2020 due in August 2020. Although HMRC are considering whether the implementation dates could be delayed, we recommend AWMs proceed on the basis that the UK implementation dates will not change..

Aspects of the draft guidance will be helpful for the asset management industry, although questions remain.

Welcome clarifications in the draft guidance:

- Main benefit test – The definition of 'tax advantage' has been restricted to taxes which DAC6 applies, i.e. EU direct taxes. This may reduce the number of arrangements disclosable under hallmarks subject to the main benefit test.
- Meaning of 'concerning' – Helpful guidance is included explaining that HMRC only consider an arrangement to 'concern' a territory if that territory is of 'material relevance' to the arrangement, and provide a number of examples to illustrate the concept. Specifically, HMRC include an example of a CIV established for investors from any jurisdiction and confirm that the fact that investors could be from different jurisdictions does not inherently make this a cross-border arrangement assuming that the location of the investors is not material to the establishment of the CIV. Thought should therefore be given as to whether the investor jurisdiction has been specifically taken into account when establishing the fund.
- Hallmark A3 – HMRC have confirmed that industry standard framework agreements (such as an ISDA) should not normally satisfy this hallmark, on the assumption that they are usually subject to significant contract-specific customisation.
- C Hallmarks –
  - 'Recipient' – HMRC have confirmed that the recipient for the purposes of these hallmarks will generally be the person/people who is/are taxable on the receipt, In the case of transparent vehicles such as general partnerships, it will be the partners, rather than the partnership, who are taxable on the receipt so in this case, it would be the partners who are the recipients for the purposes of judging whether this hallmark is met.
  - Territories without the concept of corporate tax (e.g. Cayman Islands) 'Resident for tax purposes' – HMRC have clarified whether payments to entities incorporated in territories without the concept of corporate tax should fall within hallmark C1a or either of the C1b hallmarks, and have confirmed that an entity incorporated in a jurisdiction without corporate tax should be considered under the Cb hallmarks. HMRC indicate that they consider that C1a is targeted at situations whether the non-residence arises due to a mismatch of taxing criteria between territories rather than due to the lack of tax residency concept in a jurisdiction.
  - Cb(ii) – notably the Cayman Islands – The draft HMRC guidance has clarified that it is necessary to consider whether the territory is on either of the EU or OECD list of uncooperative tax jurisdictions both at the time of the first step of implementation and 1 July 2020, to determine if an arrangement is disclosable under this hallmark. It follows that relevant arrangements involving the Cayman Islands that were implemented before the Cayman Islands was added to the 'Blacklist' earlier this year may not be reportable under this hallmark (although do consider other hallmarks).
  - C4 – HMRC have set out their view that 'material' in this hallmark refers to a difference in consideration which does not result from the normal operation of the tax legislation, such that it would be reasonable to conclude that the tax authorities would want to understand more about the arrangement and its operation. This is significantly different from, say, an accountant's interpretation of 'material'. HMRC give the example of a transfer by a UK company of shares to a non-UK resident and that disposal benefits from SSE. As long as the transaction is undertaken in a manner consistent with the normal operation of the SSE legislation, there should not be a material difference, irrespective of the tax basis available to the transferee.

UK – HMRC guidance for EU Mandatory Disclosure Rules (2/2)

- HMRC indicate that, where the D hallmarks and the OECD's Mandatory Disclosure Regime rules cover the same ground, then HMRC will interpret the D hallmarks in line with the OECD's rules. Accordingly, the OECD's guidance on MDR should be capable of being used to interpret the D hallmarks. HMRC have also clarified that, just because an arrangement results in no CRS report being made, if this is in line with the policy objective of the CRS rules, this should not be disclosable under D1.

Potential challenges remaining following the draft guidance:

- Hallmark E3 – HMRC indicate that, when seeking to determine if hallmark E3 is satisfied, it is necessary to consider it from the point of view of a hypothetical informed observer. More specifically, based on all the facts and circumstances, would a reasonable person consider that, on the balance of probabilities, the expected EBIT of the transferor should decrease by at least 50% in the following three years? This is therefore a subjective test.
- HMRC accept that intermediaries who are service providers may not know all details of an arrangement and are not required to do additional due diligence beyond that necessary to perform their services. This could result in disclosure obligations transferring to other intermediaries or taxpayers.
- Disclosure in the UK and the EU – Whilst HMRC's approach, as reflected in the UK draft guidance is generally pragmatic and helpful, arrangements may still be disclosable in the EU even if not in the UK.

Matters on which further clarification is still awaited:

- Hallmark E3 and Brexit – HMRC does not consider that it would be appropriate to carve out Brexit-related reorganisations from the legislation and the draft guidance does not shed any further light here. However, HMRC will explore whether steps can be taken to minimise over-reporting of benign transactions through further guidance. Guidance will also address sector specific issues such as the application of the EBIT test to financial sector entities and funds.
- Penalties – The draft guidance currently only sets out the circumstances in which a person may be liable for a penalty. Further guidance on penalties is to follow.

What we are seeing AWMs do to prepare

We are seeing clear trends emerging on implementation preparation. This includes AWMs first conducting an Impact Assessment on how the technical aspects of the legislation across each asset class and deal type, the level of analysis needed over transactions and structures, and determining the intermediary responsible for any reporting.

For AWMs who have repeat transactions, positions are being documented and opinions sought to ensure that where arrangements are considered not reportable, sufficient evidence is available for the position to be adopted going forward.

We are seeing AWMs considering areas such as training for Deals and Ops teams, putting in place central Tax oversight processes, and considering the role technology may play in ongoing analysis and reporting.

Next steps for asset and wealth managers

There is not long to go before the regulations apply from 1 July 2020, so AWMs need to understand their obligations and ensure that they have the systems and processes in place to comply.

AWMs should be mindful that not all EU member states follow the same guidance and some may not require certain intermediaries to have a reporting obligation, so AWMs should assess the areas where increased internal oversight of reporting obligations is required.

Operational readiness for compliance is also important as many AWMs have diverse structures, limited direct tax involvement in day to day deal team operations and a high volume of high value and complex transactions.

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Luxembourg – Potential non-deductibility for EU black-listed countries

On 30th March 2020, the Luxembourg Government tabled a Bill with the Luxembourg Parliament, setting out the draft legislation to introduce measures to deny the deductibility of interest and royalties expenses paid or due to associated parties established in EU black-listed countries, in application of the EU Council's recommendations, which would apply from 1 January 2021.

With Cayman having been added to the EU black-list recently, it is clear that this proposed legislation could have a significant impact, especially for the AWM industry.

Draft legislation – What we know so far

- Non-deductibility applies to interest and royalties paid or accrued onwards to beneficial owners which satisfy each of the following:
  - have a corporate form from a Luxembourg tax perspective;
  - are 'associated parties' (as defined for the purposes of applying Luxembourg's transfer pricing regime) to the Luxembourg taxpayer; and
  - are established in a country which is on the EU black-list (first application is proposed to be based on the list as of 1 January 2021).
- The above means that interest and royalties paid to tax transparent entities (e.g. partnerships, certain fund vehicles) should not be caught under these rules. It is important to be clear that whether or not an entity is deemed transparent needs to be assessed from a Luxembourg tax perspective.
- The Luxembourg Government will update the blacklist on an annual basis. For the first application, the reference black-list will be the EU black-list as it stands on 1 January 2021, so the black-list should be monitored for changes occurring before that date. If, as some expect, the Cayman Islands is removed from the list in October 2020, payments to Cayman resident associated parties should not be in scope for the first year.
- Currently, the EU 'black-list' names 12 countries:
  - American Samoa;
  - Cayman Islands;
  - Fiji;
  - Guam;
  - Oman;
  - Palau;
  - Panama;
  - Samoa;
  - Trinidad and Tobago;
  - Vanuatu; and
  - US Virgin Islands.
- Subsequently to 1 January 2021, changes to the EU black-list will be impacting the non-deductibility as follows:
  - countries that are added to the black-list will be subject to the Luxembourg provisions from the following 1 January; and
  - for countries that are removed from the list, the Luxembourg provisions will only apply to interest or royalties paid or due up to the date of publication of the version of the list that first removes the jurisdiction concerned. This would mean that only part of a relevant expense involved would be non-deductible for the tax year concerned.
- If it is determined that a payment arrangement does satisfy the above three conditions, it could potentially still remain deductible, but only to the extent the Luxembourg taxpayer can prove that the transaction leading to the payment has 'valid commercial reasons that reflect economic reality'. This commercial purpose test has not been defined in this context and there is not any guidance on what this means in practice yet. This will need to be assessed on a case by case basis, but could offer potential defence arguments against non-deductibility.

It should be noted that, since the 2018 tax year, Luxembourg companies have been required to indicate in their tax returns whether they have undertaken any transaction with any related party located in any of the EU black-list jurisdictions. This requirement is not affected by the new draft legislation.

Next steps for asset and wealth managers

AWMs should monitor changes to the EU black-list and identify whether they have any payments which could fall into the scope of this new legislation. In particular, the status of the Cayman Islands will be important to monitor.

It is not clear at this stage when further guidance or detail on the application of these rules will be issued, or indeed whether the Bill will pass through the full legislative process and come into law, but this should be monitored so that asset and wealth managers can assess the impact of these new rules on their business.

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Europe – European investor reporting challenges under COVID-19 (1/2)

In this article we have summarised the challenges which COVID-19 has posed asset and wealth managers in the context of their European investor reporting processes. We note that in the context of balanced funds, where the tax treatment of that investment depends on whether the fund is an equity fund or a bond fund, particular problems could arise.

Balance sheet regimes

German reporting

In 2018 the German Income Tax Act introduced a partial tax exemption in respect of funds that met certain equity ratios. Where certain ratios are satisfied, a proportion of the income (including distributions and capital gains made) are exempt from tax in the hands of local investors.

In order to qualify for the partial exemption regime, a fund should meet the requirements to be either a mixed (25% invested in equities) or an equity fund (at least 50% invested in equities).

To the extent that distribution ratios are breached, investors are treated as making deemed distributions on the same day, which is taxed on the day when any interest is disposed of. Furthermore, any such income is considered to be fully taxable and not subject to the usual partial exemption.

While there is a 20 day provision in the German tax rules to give some relief as a result of unanticipated market movements, it seems likely that the current disruption will extend for a more truncated period of time. We are aware of lobbying efforts in this respect.

Danish reporting

The new Danish regime affords individuals to classify income from funds more than 50% invested into equities (based upon a yearly average based on a number of touchpoints) as equity income as opposed to capital income, which generally has a less favourable tax treatment – the so-called 'equity test'. As for some of the other locations, the 50% equity test could be impacted by the current market arrangements.

In the event that a fund provider becomes aware that an equity test has been breached, then the fund needs to report this breach to the Dutch tax authorities within 14 working days. Non-compliance should only impact fund classifications in future years.

French funds

French individuals that invest into some French private equity funds and professional investor funds are able to benefit from favorable tax regimes if certain legal (greater than 50% of assets invested in equity-like investments not traded on a regulated market) and tax (greater than 50% of assets invested in eligible (commercial, industrial, artisanal EU/EEA) target companies that are subject to corporation tax) ratios are complied with. Failure to meet these ratios can result in 20% penalties for investors and penalties for fund managers if the legal ratios are breached. Where ratios are anticipated to be breached, it is the manager's role to apply for exemptions from penalties that can apply for up to 24 months.

P&L based regimes

United Kingdom

Under the UK bond fund rules, bond funds need to have at least a 60% by value invested in interest bearing securities to qualify as being bond funds. There is some concern that balanced funds that may not qualify as bond funds if the value of bonds were to drop (or vice versa). There is no carve out from the rules for inadvertent bond fund regime entry.

Next steps for asset and wealth managers

Asset and wealth managers are encouraged to ensure that they understand the inherent risks to their European investor reporting processes given the current market fluctuations. The extent to which these are being mitigated, or not, by extraordinary measures introduced by local tax authorities varies from jurisdiction to jurisdiction, so it is important that AWMs understand the regulations and are ready to act as required to avoid being subject to an unexpected tax treatment.

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UK – CRS Reportable jurisdictions and excluded accounts

As we enter the annual reporting season for both the Foreign Tax Compliance Act ('FATCA') and the Common Reporting Standard ('CRS'), there are some notable changes that affect Financial Institutions with Reportable Accounts.

Recent changes in relation to CRS Reportable jurisdictions for 2020 include the removal of the following jurisdictions from the list. An update to that effect is also provided in HMRC's International Exchange of Information Manual ('IEIM402340'):

- Albania
- Oman
- Peru

This will particularly affect asset and wealth managers ('AWMs') that have already prepared their returns for submission. As in previous years, HMRC's view continues to be that it may not be possible for AWMs to remove data from returns at this stage, so HMRC will accept returns that include data for these jurisdictions in those circumstances.

Furthermore, The International Tax Compliance (Amendment) Regulations 2020, amending the International Tax Compliance Regulations 2015 ('the Regulations'), has removed four types of Excluded Accounts from the Regulations. An update to that effect is also provided in HMRC's International Exchange of Information Manual (IEIM 401740, 401760 and 401820):

- Non-registered pension arrangements (annual contributions are limited to £50,000 and funds cannot be drawn down until 55 years old, unless serious ill health);
- Premium Bonds issued by the UK National Savings and Investments;
- Fixed Interest Savings Certificates issued by the UK National Savings and Investments; and
- Index Linked Savings Certificates issued by the UK National Savings and Investments.

This means that these types of accounts will be considered Financial Accounts and are potentially reportable so that AWMs should consider whether to include them in their returns from 13 May 2020 onwards, which is the effective date for documenting these accounts as either new or pre-existing.

Next steps for asset and wealth managers

AWMs should ensure that they are aware of the jurisdictions which have been removed from the CRS Reportable jurisdictions list for 2020 and the impact this could have on their returns.

It will also be crucial to be cognisant of the types of account which could be considered reportable as of this month.

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