Keeping up with Alternative Investment Funds

May 2020

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Introduction

Welcome to our May edition of Keeping up with Alternative Investment Funds. As was at the time of our previous edition, we still find ourselves working in extremely unprecedented and challenging times and we hope that you remain safe. It seems like these circumstances will continue for the foreseeable future and we continue to adapt to the challenges which Covid-19 presents and this new way of working.

We understand that there have been a number of changes to working life and our dedicated firmwide **Covid-19 website** 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.

On tax matters, EU Economy Commissioner Paolo Gentiloni has stated on 27 April that the Commission is prepared to adopt a flexible stance on the reporting and exchange requirements under DAC 2 and DAC 6 reporting. See the News Bulletin on page 2 for more detail.

We hosted our latest virtual client roundtable on 6 May 2020 where we were joined by Lord Gavin Barwell, former Downing St Chief of Staff to Theresa May and now Strategic Advisor at PwC.

Gavin took us through how the Covid-19 pandemic was progressing in the UK compared with other countries, the possible exit strategy from lockdown and what the likely long-term implications of the crisis would be for clients. His presentation provided deep insight around the current challenges caused by Covid-19 to over 150 attendees and some useful thinking around the potential long-term geopolitical and macroeconomic trends arising in future.

Looking ahead, we are asking for feedback from clients on the virtual client roundtables held to date regarding frequency (bi-monthly vs monthly), content, format and any suggested topics to be covered at future events. Please contact **richard.madden@pwc.com** if you have any feedback or suggestions.

Our May newsletter covers a wide variety of topics including updates as a result of Covid-19, the EU blacklisting of the Cayman islands and for the first time we have an Alternatives special where we collaborate with our Irish team to provide you with a deep dive into areas that are topical in Ireland. Based on feedback from clients, we will do ad-hoc deep dives so that you get the benefit of our global insight at your fingertips.

See full list of articles in this newsletter below:

- UK – The corporate governance and tax documentation challenges of Covid-19
- Lux – Potential non-deductibility for EU black-list countries (attention Cayman Islands)
- UK – MTD deferred and support for VAT under COVID
- UK – HMRC and OECD guidance on PE and residence (Covid-19)
- European Investor reporting challenges under Covid-19
- Carried Interest – What should you be considering?
- Overseas Deep Dive: Ireland

Please do continue to reach out to your usual PwC contacts if you would like to discuss any of the above, and please do share your feedback with us if there is a particular topic or issue you would like us to cover.

Kind regards,

Marc Susgaard-Vigon
Partner
M: +44 (0) 7795 222478
E: marc.susgaard-vigon@pwc.com

Robert Mellor
Partner
M: +44 (0) 7734 607485
E: robert.mellor@pwc.com

News Bulletin

DAC 6 Delays

The **EU Commission has proposed a delay to the implementation of DAC** following a letter sent on 28 April by the Croatian EU Presidency to the Fiscal Counsellors asking if the Member States can agree to the below modifications:

- Defer the deadline for exchanges of information under DAC2 by 3 months;
- Change the date for first exchanges of information under DAC6 from 31.10.2020 to 31.12.2020;
- Change the date for launching the 30-day deadline for the reporting of information under DAC6 from 01.07.2020 to 1.09.2020.
- Change the date for the reporting of 'historical' arrangements under DAC6 (i.e. arrangements that became reportable from 25.6.2018 to 30.6.2020) from 31.8.2020 to 31.10.2020.

The letter further states that: "any deferral of deadlines for reporting and exchanging information under DAC2 and DAC6 should be of a limited duration. Moreover, it should be ensured that all information which would otherwise become reportable under either DAC2 or DAC6 during the agreed deferral period will still be reported and exchanged once the deferral be terminated." We will keep you updated to the extent there are any updates on this front.

HMRC extends UK Asset HoldCo and Hybrids Consultation

HMRC has announced yesterday (28/04/2020) that they will be extending the response periods for their consultations on both UK asset holding companies in alternative fund structures and hybrid and other mismatches.

The deadline to respond to the tax treatment of asset holding companies in alternative fund structures **consultation** has been extended to 19 August 2020.

The deadline to respond to the hybrid and other mismatches **consultation** has been extended to 29 August 2020.

In light of COVID-19 both consultations have been extended to give relevant parties more time to submit their views.

Reminder of upcoming deadlines:

Form 42

Any employers that award carried interest and co-investment rights need to think about whether they need to report these on their Employment Related Securities online report (formally called "form 42").

Normally this report involves reporting share options and restricted shares held by employees or directors. However it also requires certain partnership awards like carry and co-invest to be reported. Companies need to register their arrangements with HMRC and file online annual returns setting out certain activities including new awards to employees which have occurred during the 2019/20 tax year by 6 July 2020.

It can be difficult to complete this report, particularly as HMRC tools and guidance were not designed to allow for partnership interests to be reported. Getting your reporting right this year is particularly important as HMRC are increasingly scrutinising the employment taxes treatment of these types of awards given the changes to the taxation of carried interest. If you've made any awards during 2019/20 we can help you be compliant across all aspects of the process, let us know if you'd like to discuss.

Marc Susgaard-Vigon
Partner
M: +44 (0) 7795 222478
E: marc.susgaard-vigon@pwc.com

Robert Mellor
Partner
M: +44 (0) 7734 607485
E: robert.mellor@pwc.com

The corporate governance and tax documentation challenges of Covid-19

Introduction

Covid-19 has had an unprecedented impact on our lives and the way we work, how we socially interact and how companies of all sizes conduct business. Companies across the world are quickly learning how to adapt their current working practices and how to consider their legal and governance obligations, including how they conduct meetings, how best to address document execution, and adhere to ongoing regulatory commitments. As the international response continues to develop each day, it is clear that organisations are facing potentially significant challenges to which they need to respond rapidly.

With this in mind, 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 AGMs, holding board meetings, complying with Market Abuse Regulations and with DTR requirements, and document execution. This article mainly discusses listed funds, however it highlights areas related to unlisted funds and legal entities, where necessary.

Please note that the content in this article contains the latest regulatory information at the time of writing, this is a rapidly changing situation that may render some information out of date at the time of reading.

AGMs

Those companies who 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:

- 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.
- For 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 is similar - 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.

Market Abuse Regulations/Disclosure, Guidance and Transparency Rules

Turning to Market Abuse Regulations ("MAR") and Disclosure, Guidance and Transparency Rules ("DTR"), regulatory guidance differs between each country, and will be discussed in turn below.

United Kingdom

Whilst the majority of the obligations remain unchanged (e.g. MAR obligations), the 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 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, 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) have been extended to 30 June 2020.
- 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.

Ireland

For authorised investment funds, the following audited financial statements can be delayed by two months and one month, respectively:

1. 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
2. annual audited financial statements referring to a year end
    a) on or after 1/4/2020 but before 1/5/2020; or
    b) on or after 31/1/2020 but before 1/4/2020 can be delayed by one month.

The corporate governance and tax documentation challenges of Covid-19 Cont.

For investment firms, filing of following accounts and returns can be delayed by two months and one month, respectively: have been changed

1. 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
2. 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

Turning to document execution, electronic signatures are generally accepted across the three jurisdictions, with a couple of nuances:

- Within the 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.
- For *Ireland*, they are unlikely to be permitted for documents that are required to be executed under the seal.
- Concerning *Luxembourg*, they cannot be used for contracts creating or transferring rights on real property, contracts requiring intervention by tribunals, or public authorities.

Next steps for Alternative Investment Funds

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.

We recommend Alternative Investment Funds continue to monitor any ongoing changes to the legal and regulatory obligations.

Kate Graham
Partner
M: +44 (0) 7595 850630
E: kate.graham@pwc.com

Kit Dickson
Partner
M: +44 (0) 7789 273879
E: kit.dickson@pwc.com

Jasleen Grewal
Manager
M: +44 (0) 7704 073922
E: jasleen.grewal@pwc.com

Luxembourg Update: Potential non-deductibility of payments to EU black-list countries

Background

The Luxembourg Government announced on its website on 25th March 2020 that it planned 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. Subsequently, on 30th March 2020, the Luxembourg Government tabled a Bill with the Luxembourg Parliament, setting out the draft legislation 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 asset and wealth management 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 clarification 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 present the relevant black-list for the purposes of the third condition above on an annual basis. For the first application, the EU black-list condition is dependent on the list as it stands on 1 January 2021, so the black-list should be monitored for changes occurring before that date. To the extent that the Cayman Islands is removed from the list in October 2020 (which Cayman Islands is confident of), payments to Cayman resident associated parties should not be in scope for the first year. Currently, and since 27 February 2020, this EU "black-list" names 12 countries or territories, as follows: American Samoa; Cayman Islands; Fiji; Guam; Oman; Palau; Panama; Samoa; Trinidad and Tobago; Vanuatu; US Virgin Islands.
- For subsequent applications of the black-list condition, countries that have been 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 Alternative Investment Funds

- Identify any payments within your group which meet the three conditions and therefore could fall into the scope of this new legislation. As an overlay, consider potential application of the commercial purpose test.
- Monitor changes to the EU black-list. 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.

Tim Hill
Director
M: +44 (0) 7734 958732
E: tim.hill@pwc.com

Emily Dugard
Senior Manager
M: +44 (0) 7730 599252
E: emily.dugard@pwc.com

MTD deferred and support for VAT under Covid-19

VAT – Key updates

1. Covid-19: Deferral of VAT payments due

On 20th 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.

2. 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.

3. 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 updated on a daily basis.

https://globalvatonline.pwc.com/covid-19-summary

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.

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". However, it is not anticipated that these conditions shall be subject to an in-depth test by the German tax authorities. 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.

MTD deferred and support for VAT under Covid-19

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.

Please refer to the PwC COVID-19 website noted above for further details on the individual country VAT/indirect tax measures.

4. Making Tax Digital – deferral

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.

Next steps for Alternative Investment Funds

Alternative Investment Funds that have, or will have, a payment (or payments) of VAT falling due in the period 20 March 2020 to 30 June 2020 should fully consider whether this deferral could assist their business in these uncertain economic conditions. Please let us know if you require any assistance with the process.

We also recommend that Alternative Investment Funds continue to monitor emergency tax measures in overseas territories where they have operations or a presence.

Should you wish to discuss any of the COVID-19 measures both in the UK or elsewhere or the MTD deferral, please contact Daniel Evans on 07595 611440.

Daniel Evans
Director
M: +44 (0) 7595 611440
E: daniel.evans@pwc.com

Nikki Reale
Senior Manager
M: +44 (0) 7525 281952
E: nikki.s.reale@pwc.com

HMRC and OECD guidance on PE and residence (Covid-19)

In brief

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 forthcoming **guidance** indicates that a change in the worker location over a short period would 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.

Other countries

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

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.

HMRC and OECD guidance on PE and residence (Covid-19) cont.

PwC UK observation

UK

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 Alternative Investment Funds

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.

Amanda Pybus
Director
M: +44 (0) 7787 863825
E: amanda.m.pybus@pwc.com

Rochelle Gianfrancesco
Senior Manager
M: +44 (0) 7701 296047
E: Rochelle.m.gianfrancesco@pwc.com

Europe – European investor reporting challenges under Covid-19

In this article we have summarised the challenges which COVID-19 has posed alternative investment funds 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

In a UK context, many alternative fund managers rely on the Unlisted Trading Company Exception in the Offshore Fund Rules. This is utilized by many Private Equity and Debt funds to exempt themselves from tax reporting to UK investors. This rule relies on the fund being able to hold more than 90% of its assets in unlisted companies (with some minor exceptions for short term holdings in listed companies). With capital market price swings in such a state of flux, this 90% threshold should be monitored.

Next steps for Alternative Investment Funds

Alternative Investment Funds 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 Alternative Investment Funds understand the regulations and are ready to act as required to avoid being subject to an unexpected tax treatment.

Hazell Hallam
Partner
M: +44 (0) 7954 404977
E: hazell.hallam@pwc.com

James Stewart
Director
M: +44 (0) 7469 033107
E: james.w.stewart@pwc.com

Carried Interest – What should you be considering?

Believe it or not, it has been nearly five years since the introduction of the Disguised Investment Management Fee ("DIMF") and carried interest legislation. These rules overhauled the way in which Investment Managers are subject to tax in the UK, creating a more complex landscape for Alternative Investment Fund managers and their executives to navigate.

HMRC have given some time for this legislation to bed down, to allow for the industry (and themselves) to become familiar with and to better understand how these rules should apply in practice. While we are still awaiting final/updated guidance, we are seeing more activity from HMRC, who are seeking to ensure that the legislation is applied as they intended.

However, it is not only these rules that Alternative Investment Funds need to consider in relation to their carried interest schemes and they aren't something that only need to be looked at (hopefully) when carry is paid out to your executives.

Rather, there are a number of times throughout the carry lifecycle (from designing your carry scheme, granting carry to your executives, to reporting and disclosure via self-assessment), where tax should be considered to make sure you are compliant with any employment PAYE and disclosure obligations and to ensure that the returns from the carry scheme are subject to tax as you intended and reported correctly on each executive's tax return.

Bringing all of these areas together is important for an effective carry scheme and this article summarises the key things for you to look out for along the way.

Designing your carry scheme

Despite the various changes to the tax and commercial landscape, carried interest still remains a key component for incentivising executives.

Under the DIMF and carried interest legislation, carried interest that meets one of two definitions, can be subject to tax at capital gains tax rates of 28% instead of as DIMF at up to 47%. Therefore, whilst many schemes use terminology such as "carry", "carried interest", "incentive" or "promote", it is important that the structure of the returns is in accordance with the legislative provisions should you wish to fall within the treatment prescribed by HMRC - just because something is called "carry" doesn't mean that it will be taxed in the way that you had envisaged!

When looking at incentivising your executives, the structure of their carry should be taken into account, but how much should you give away? What is the industry standard? Are you awarding too much or too little to attract and retain your key talent? Benchmarking can be of real importance here to make sure you are getting the right balance across all elements of executive compensation.

As you can see, taking the time to consider the carry scheme at the outset, has a number of benefits:

- It helps to provide clarity of tax treatment for future carry pay-outs (subject to changes in legislation) and where possible such that they fall within the legislative framework for carry;
- It assists with efficient reporting of future realisations as there is transparency over how carry is expected to be realised (particularly when this is looked at alongside each deal acquisition); and it helps you to remain competitive and attract and retain key talent by assessing how carry fits into overall compensation.

Awarding carry to executives - Employment taxes, joint elections under s431 ITEPA 2003 and Online Reporting

Once you decide to award carry to your executives, this can trigger a number of employment tax requirements under the Employment Related Securities ("ERS") rules. The tax implications (and associated considerations) will typically depend on:

- whether the carry meets the conditions of the Memorandum of Understanding (2003) ("MoU") between HMRC and the British Venture Capital Association ("BVCA"); and
- The timing of the award of carry (this includes late awards of carry or reallocations).

MOU compliant carry

Traditionally, where carried interest meets the conditions of the MoU and it is granted to employees:

- Prior to any investments having been made by the fund; and/or
- whilst it can be shown that the aggregate value of the fund's investments (if any) has not increased above their aggregate acquisition cost (to be considered on a case by case basis),

the amount actually paid for the carry shall be treated as the initial Unrestricted Market Value ("UMV") and therefore, no employment tax charge should arise on the award.

In addition, provided a joint election is made (under s431 ITEPA 2003) ("s431 election") between the executive and the employer, no further employment tax charge should arise when restrictions are lifted. The election does not need to be filed with HMRC, but must be made **within 14 days of the award**. Failure to make the election may lead to some of the future growth becoming subject to tax as employment income instead of potentially capital gains and therefore this could end up being a costly mistake.

Non-MOU compliant carry/late awards of carry or carry reallocations

However, where a carry scheme is not MOU compliant or the conditions above are not met, an employment tax charge may arise. This is most commonly seen where funds are making late awards of carry or reallocations of carry to their employees and therefore it is particularly important to be mindful of this.

As the MOU would not be in point, a valuation would be required to demonstrate the value of the award that has been granted to employees, to ensure that employees pay the appropriate amount for their carry/PAYE is operated on the correct value.

The employer and employee should also continue to consider making the s431 election for these awards within the 14 day time limit.

Carried Interest – What should you be considering? Cont.

In addition, carry that is not compliant under the MOU would typically need to fall within the second definition of carried interest (under s809 EZC ITA 2007). Therefore to determine if these awards would be qualifying carried interest, it would also be necessary to work out if there:

had been a material change to the arrangements; and

is significant risk that a sum may not arise

If these conditions are not met, the carried interest would not qualify and future proceeds would be subject to tax as DIMF.

Annual Online Reporting of carry awards

If an employer awards carried interest to their employees (and other ERS e.g. co-investment rights), they will need to report these on their ERS online report (formerly called "form 42").

Normally this report involves reporting share options and restricted shares held by employees or directors. However, it also requires certain partnership awards to be reported. Employers need to register their arrangements with HMRC and file online annual returns setting out certain activity by 6 July following the end of the tax year. A return may still need to be filed each year even where no subsequent awards have been made.

It can be difficult to complete this report, particularly as HMRC tools and guidance were not designed to allow for partnership interests to be reported (which is the typical structure of a carry scheme). Getting the reporting right is particularly important as HMRC are increasingly scrutinising the employment tax treatment of these types of awards, particularly where the awards are reported as having little value.

Carry pay out

When carry pays out, the carry recipients are required to report the sums that arise to them on their UK tax returns by 31 January following the end of the tax year in which the carry arises.

Whilst it is the responsibility of the executives to report and disclose carry on their tax returns, they will need support to understand:

1. Whether the carry that they are receiving is qualifying carried interest (i.e. meets one of the two carried interest definitions) and not DIMF;
2. The underlying nature of the return that gives rise to the carry (dividend, capital gain, interest etc); and
3. The availability of base cost (e.g. if they have paid for or been subject to employment tax on award of their carry).

It can be seen that by considering this throughout the course of the carry lifecycle (i.e. taking these points into account when designing your carry scheme and awarding carry to your executives), the process to determine the tax position of the carry receipts becomes easier and will allow for more efficient reporting. We are working with a number of clients to provide investor reporting services to their executives and there is a key emphasis in using technology to streamline the process.

Income Based Carried Interest ("IBCI") rules

However, even if carry is qualifying carried interest, it may still fall within the scope of DIMF if it is deemed to be IBCI. This is not something that can be determined until the point at which the carry is paid out as the rules look at the Weighted Average Holding Period ("WAHP") of the investment scheme.

The IBCI rules apply to carry awards that are not ERS (i.e they typically apply to carry that has been awarded to partners and not employees) and seek to tax carry returns at up to 47% where the WAHP is less than 40 months.

These rules are particularly complex and include a number of exceptions (i.e some funds are automatically IBCI irrespective of the WAHP) and rules that can extend the WAHP. In addition, where carry is received in the early stages of a fund, it may be possible to claim that the carry is conditionally exempt IBCI if it is anticipated that the WAHP of the fund will be at least 40 months in the future (this has to be retested at a defined point in time and tax returns refiled if the determination was incorrect).

Calculating the WAHP can be time consuming, time pressured (as the assessment cannot be made until the carry is paid) and complicated and based on our experience often relies on a magnitude of data from many sources. As this is a matter for the individual, there is a reluctance to dedicate resource in this area and therefore to comply with these rules and to provide the necessary support to their executives, Houses are turning more to their advisers and the use of technology based solutions.

Non-U.K. domiciled executives

In addition to determining the tax position of the carried interest returns, non-UK domiciled executives (that claim the remittance basis), will also need to consider the proportion of their carry that is taxable in the UK. If an executive is non-UK domiciled (and they claim the remittance basis), they are only subject to tax in the UK on the proportion of their carry that relates to UK services. It is important to accurately determine the proportion that is taxable and there are many ways of approaching this based on a simple day-count or a more complex value based analysis.

It is important to note that whilst an individual may only be subject to tax on the proportion of their carry that relates to UK services, they will only be able to access these cash if their carry is segregated at the fund level and paid into two bank accounts (one relating to UK services and one relating to non-UK services). Under the rules in place, it is not possible for the individuals to segregate the cash themselves once the carry has been received. The majority of Alternative Investment Funds are accommodating of this and we see varying degrees of support from looking at each individual carry payment in isolation to applying the same split to carry payments throughout the tax year.

HMRC enquiries

As can be seen from the article so far, there are a number of points along the way where tax needs to be considered in the life of a carry scheme, but why is it more important than ever to make sure you have covered everything?

The answer lies in the complexity of the rules and the interaction with your specific facts and circumstances. Even though a number of these areas ultimately revolve around self-assessment, if executives are to be certain of the tax treatment of their carried interest, they need input from the House.

Carried Interest – What should you be considering? Cont.

Over the last 18 months, we have seen a number of HMRC enquiries into executive tax returns - some involving several executives at the same House, whilst others may only be in relation to one individual. In order for HMRC to get comfortable with the reporting and disclosure of carry, they typically request evidence that:

- The carried interest is qualifying carried interest (i.e. meets the definition of carry as per the legislation);
- Does not meet the conditions of IBCI (i.e. they want to look at the WAHP and the methodology that has been adopted);
- If foreign tax has been levied on the carry, that the correct foreign tax credit has been claimed; and
- If the recipient is non-UK domiciled, that the carry has been paid into two separate bank accounts and the proportion attributable to UK services is appropriate.

All of these points require some level of information to be provided by the House and in fact, HMRC regularly expect the House to engage with them to provide this evidence (which makes it even more important for this information to be provided to the executives from the outset - i.e. when preparing their returns).

To date, we are yet to see HMRC exercise their information powers to request data from the House, but rather there has been a desire to engage on a collaborative basis. HMRC have been particularly agreeable to the House providing a coordinated response on behalf of all of the executives under enquiry as this removes the burden for the executives, avoids duplicate information requests, allows for one key point of contact to deal with all cases (giving consistency in conclusions) and enables HMRC to better understand the carry structure through dialogue with those that are most familiar with it.

It is clear that this is a focus for HMRC and the nature of the enquiries would imply that they are keen to better understand the structures that the industry typically use. There are a number of things that can be done prior to submitting a tax return that can help manage an enquiry (e.g. considering the inclusion of relevant disclosures) and we have significant experience in helping clients to navigate through this type of enquiry, particularly where the House leads on behalf of the executives.

Next steps for Alternative Investment Funds

Carried interest is a complex matter with wide ranging implications for both asset managers and executives.
To act as an effective form of incentivisation and to ensure that businesses and their executives are compliant with their reporting obligations, it is important to seek advice when:

- Contemplating putting in a new carry scheme or making changes to an existing scheme;
- Awarding carry/making reallocations of carry or granting carry later in the life of a fund;
- Reporting carry via self-assessment and making payments of carry to individuals; and
- Dealing with HMRC enquiries

The Alternative Investment Fund Network within PwC can support you throughout the carried interest journey to make sure you get the right result for you and your teams by bringing together specialists that can help you each step along the way. Our aim is to lighten the load that comes with implementing and managing a carry scheme and we have a key focus on technology to help to facilitate this.

Laura Morris
Director
M: +44 (0) 7868 735963
E: laura.morris@pwc.com

Kam Dhillon
Senior Manager
M: +44 (0) 7985 439639
E: kam.dhillon@pwc.com

Overseas Deep Dive: Ireland

Over the coming months, PwC Ireland's Alternative Investments Tax team will be contributing to the newsletter, focusing on the Irish Alternative Funds industry and its key components. This month's contribution is a high level overview of the industry in Ireland and the main Irish structures utilised by alternative asset managers. We also look at Ireland's scorecard to date on navigating the ever-changing international tax landscape and set the scene for future contributions in relation to how Ireland will need to continue to adapt and evolve in response to further legislative reform and market trends.

Overview of Irish Alternative Funds Industry

The Irish funds industry is synonymous with alternative investments, having long been renowned as a domicile for setting up and servicing alternative fund structures. This is evidenced by the growth from €151bn of alternative assets under management in Irish regulated funds in 2009 to in excess of €751bn at present. Similarly, in an unregulated context, as of Q4 2019, Irish Special Purpose Vehicles ("SPVs") had in excess of €850 billion of assets under management.

As these figures demonstrate, Ireland is home to a mature funds industry and its success is linked to a number of key factors. As well as access to the EU market, which provides a number of regulatory and tax benefits, fund managers can rely on a diverse product suite which can be serviced locally by an experienced "eco system" of high quality service providers. Furthermore, the Irish tax regime has been, and continues to be, one of the key growth drivers of the funds industry in Ireland.

The strategies housed within Irish alternative funds span hedge funds, private equity, private debt, infrastructure, real estate as well as a significant number of aircraft leasing and shipping funds. The Irish Collective Asset-Management Vehicle ("ICAV") and S.110 company remain the most popular Irish regulated and unregulated structure respectively, but we have seen many alternative asset managers utilise lesser known Irish structures of late. In this article we recap on the current Irish product suite and the tax regime as it applies to the most popular class of Irish investment funds. We also consider the impact that the changing global tax landscape and upcoming unilateral tax reform is likely to have on the Irish alternatives landscape and structure of choice for asset managers going forward.

Popular Irish structures for alternative investments

Irish Collective Asset-Management Vehicle ("ICAV")

Since its introduction in 2015, the ICAV has become the vehicle of choice for alternative fund promoters seeking a regulated vehicle. The ICAV has replaced the investment company or PLC structure as the preferred corporate vehicle for investment funds in Ireland. The ICAV is not a company under the Irish Companies Acts, but rather a corporate entity with its own facilitative legislation that has been drafted specifically with the needs of investment funds in mind.

An ICAV is typically established as an umbrella structure with a number of sub-funds and share classes. Each sub-fund has segregated liability and can provide for differing investment strategies and investor pools. It is possible to prepare accounts on an individual sub-fund basis. This ensures that investors in a single sub-fund of an umbrella with multiple sub-funds only receive information that is relevant to them and allows managers to scale the structure which provides flexibility and economies of scale.

Section 110 Companies

A S.110 company is a special purpose structured finance vehicle. The S.110 company provides a flexible structure that does not require Irish Central Bank approval. Investors typically invest directly into the S.110 company through individual profit participating notes or through a limited partnership which holds the profit participating note. This structure is widely used by asset managers, international banks, and investment funds for securitisations, investment platforms, CLOs, CDOs, capital market bond issuances and asset lessors. Irish S.110 companies are used extensively in aviation financing, for which Ireland is a global hub.

The ability to operate within an onshore regime is attractive to many asset managers in an environment where there is an increased international focus on tax havens and transparency. As an unregulated vehicle, a S.110 company is cost efficient and can be established within a short time frame.

Limited Partnerships

Irish law currently provides for two distinct limited partnerships, those established as regulated investment limited partnerships under the Investment Limited Partnership (ILP) Act of 1994 ("ILPs") and those structured as unregulated limited partnerships under the 1907 Act ("1907 LP"). An ILP can only be established as an AIF and is authorised and regulated by the Irish Central Bank. Both the ILP and the 1907 LP are common law partnerships, typically formed by the execution of a limited partnership agreement, between at least one general partner and one limited partner.

Notwithstanding the aforementioned growth in alternative funds in Ireland, and the increasing allocations towards private assets (which are typically housed in tax-transparent structures), the Irish limited partnership offering has not experienced a level of growth that market trends would suggest. This is due to certain legal features which can create operational and commercial constraints. Despite these constraints, 1907 LPs are used in practice and have been extensively used in real estate holding structures. They have also proved to be a viable option for asset managers seeking alternatives to offshore limited partnership structures in light of the recent EU blacklisting of certain territories. However, significant changes are expected to Irish limited partnership law that, if enacted, will offer increased opportunity to use the regulated ILP. Further detail on the proposed reform is included below for your ease of reference.

Overseas Deep Dive: Ireland Cont.

Irish Trading Company

As outlined below, Ireland applies a corporation tax rate of 12.5% on profits earned in the course of an active business (a trade). In certain cases, the activities and operations carried out in Ireland with regard to underlying portfolio investments may be sufficient to constitute a "trade" from an Irish perspective. This is aligned with the increased levels of substance which are being inserted by asset managers into the product jurisdiction, typically fuelled by regulatory, operational and tax requirements.

While this structure will not be appropriate for all strategies, a lower statutory corporate tax rate coupled with the reduced quantum of leverage typically inserted into a trading company may be preferable in light of some of the reform noted below. As well as being a viable unregulated alternative for structures which may be adversely impacted by the interest limitation rules, the levels of activity and substance required to constitute a trade from an Irish perspective may also be helpful from a double tax treaty ("DTT") access perspective.

Irish Holding Company

Ireland is a popular choice for holding companies due to its capital gains participation exemption, generous foreign tax credit system, membership of the EU, wide DTT network and tax efficient repatriation mechanisms. That said, while extensively used by US multinationals and Irish head quartered PLC groups, the structure is less popular in the financial services space due to certain features of the regime. Albeit that, in the majority of cases, foreign dividend income is effectively exempt from Irish taxation through foreign tax credit relief, the calculation of this relief is complex and burdensome to administer. It is particularly difficult to manage with respect to joint ventures, non-controlled shareholdings and income arising from multiple jurisdictions as the information required to compute the foreign tax credit may not be available to the Irish taxpayer. This added complexity acts as a disincentive for Ireland as a holding company location for asset managers in certain instances.

As a result, changes are expected to the Irish participation exemption regime that, if enacted, will offer increased opportunity to use this structure for alternative investments. Further detail on the proposed reform is included below for your ease of reference.

Common Contractual Fund ("CCF")

A CCF is a contractual arrangement established under a deed, which provides that investors participate as co-owners of the assets of the fund. The CCF is authorised and regulated by the Central Bank. The ownership interests of investors are represented by "units", which are issued and redeemed in a manner similar to a unit trust. The CCF is an unincorporated body, not a separate legal entity and is transparent for Irish legal and tax purposes.

As a result, investors in a CCF are treated as if they directly own a proportionate share of the underlying investments of the CCF rather than shares or units in an entity which itself owns the underlying investments. Similar to an ICAV, a CCF can be established as a UCITS fund or an AIF. Tax transparency is a key feature which differentiates the CCF from an ICAV. Over the past 3 years, assets under management of CCFs have increased by 150% from $40 billion to over $100 billion with $62 billion of assets under management now sitting in AIF CCFs. While the tax efficiencies from pooling assets in this structure can be significant, the structure is more costly to run and only caters for institutional clients, so the suitability of this structure is typically specific to certain fact patterns.

Key features of Irish Tax Regime

As noted above, the ICAV and S.110 company remain the most popular Irish regulated and unregulated structure respectively. A high level overview of the Irish tax regime as it applies to these structures is outlined below. In the context of investment funds, Ireland adopts a tax neutral regime, which has been the case since the establishment of the International Financial Services Center in 1987 and it remains a key driver of the Irish funds industry. Limited partnerships and CCFs are tax transparent from an Irish tax perspective and consequently provide investors with a pooling vehicle that can facilitate a "bring your own treaty" type model.

The standard rate of corporation tax in Ireland is 12.5% on trading income. A rate of 25% applies to non-trading income and certain trades. However, a special regime exists for investment funds such that they are effectively tax neutral from an Irish tax perspective.

The Irish framework is legislation-based and does not rely on rulings.

ICAV

Irish regulated funds are exempt from Irish tax on income and gains derived from their investments and are not subject to any Irish tax on their net asset value. There are additionally no net asset, transfer or capital taxes on the issue, transfer or redemption of units owned by non-Irish resident investors. Other than in respect of certain funds which hold interests in Irish real estate (or assets that derive their value from Irish real estate), non-Irish investors are not subject to Irish tax on their investment and do not incur any withholding taxes on distributions from the fund provided the appropriate documentation is in place.

Irish legislation provides for the efficient and effective redomiciliation of funds to Ireland. It allows offshore corporate funds from certain prescribed jurisdictions to migrate to Ireland by re-registering as an Irish UCITS or AIF authorised by the CBI while maintaining its legal identity and track record. Funds from the following jurisdictions can re-domicile to Ireland in an efficient manner: The British Virgin Islands, The Cayman Islands, Jersey, Guernsey, Bermuda and The Isle of Man.

An ICAV can make a check-the-box election to be treated as tax transparent for US federal income tax purposes.

S.110 Companies

An Irish S.110 company is a special purpose vehicle. It is a standard Irish company which elects into the Section 110 tax regime provided certain conditions to be treated as a "qualifying S.110 company" are met.

The S.110 company is subject to Irish tax at 25% on profits, but when structured correctly, and subject to meeting certain anti-avoidance provisions, profit participating interest payments are tax deductible.

Overseas Deep Dive: Ireland Cont.

Irish Interest payments can also generally be made free of Irish withholding taxes subject to certain conditions being met.

A S.110 company can make a check-the-box election to be treated as tax transparent for US tax purposes.

Other important tax features

Value Added Tax ("VAT")

There are a number of other areas within the Irish alternatives industry that facilitate the establishment of an effective fund structure. For example, the provision of management, administration and custody services to an Irish fund is typically exempt from Irish VAT. Management is broadly defined in this context and can create significant efficiencies in terms of how fee flows are directed. Furthermore, to the extent that VAT is charged to a fund, it is possible to recover an element of that VAT by reference to the number of non-EU investments/investors within that fund structure. This regime is applicable to both an ICAV and S.110 company.

Tax treaty network

Ireland has an extensive tax treaty network with over 70 treaty partners. While the availability of treaty benefits in a particular case will ultimately depend on the relevant tax treaty and the approach of the tax authorities in the treaty country, this can often significantly reduce portfolio tax drag.

A changing tax and product landscape

The changing global tax landscape and upcoming unilateral tax reform across multiple jurisdictions is undoubtedly going to have an impact on the product of choice going forward. Given the many challenges facing asset managers in an evolving global economy, the importance of a structure that is both efficient and operationally effective has never been greater. The industry continues to experience new challenges in the form of tax, regulation, technological disruption and volatility in international markets. Some key areas of reform which are expected to impact on the Irish alternatives landscape are set out below. These topics will be considered in more detail in subsequent articles.

Domestic Legislative Reform

The Irish Finance Bill 2019 contained the legislation required to align Ireland's current transfer pricing rules with the 2017 OECD Transfer Pricing ("TP") Guidelines and broaden the scope of TP in Ireland. Helpfully, the expansion of the TP rules have not been extended to regulated funds or profit participating loans/notes ("PPL/Ns") issued by Section 110 companies thus ensuring that these collective investment vehicles can continue to meet their policy objectives. However, in addition to TP changes, the Bill introduced additional anti-avoidance provisions with respect to Section 110 companies in order to strengthen the existing protections included within the regime. Irish policy makers have been clear in their appreciation of the policy rationale for the need for a tax neutral structure but have sought to implement measures to target aggressive structures so as to ensure the regime is robust and future proof.

The Bill also contained a number of property related measures which are relevant to investment funds which hold interests in Irish property, commonly referred to as Irish Real Estate Funds or "IREFs".

Overseas Deep Dive: Ireland Cont.

EU Anti- Tax Avoidance Directive ("ATAD") II - Anti-Hybrid Rules

Finance Bill 2019 also introduced anti-hybrid rules into Irish tax law with effect from 1 January 2020. The anti-hybrid rules are very complex and introduce some important new definitions and concepts into Irish tax legislation. In terms of the potential impact of the new legislation on the Irish alternatives sector, the measures which apply to payments under hybrid financial instruments are likely to require consideration for any payments under PPL/Ns typically made by S.110 companies. Further, the most significant impact is likely to be on groups or investment structures where US shareholders or investors are involved, due to the US "check-the-box" elections which can give certain entities (such as an ICAV or S.110 company) a specific US tax designation.

Overall, Ireland has sought to introduce the anti-hybrid rules in a form which closely aligns with the wording of the ATAD II Directive. The rules do not go beyond the requirements of the Directive which is welcome. Furthermore, the fact that the measures have been transposed in a manner which ensures the provisions can interact and coexist with existing Irish tax concepts will likely provide much needed certainty to taxpayers. Notwithstanding this practical approach the complexity of the rules should not be underestimated.

Guidance from Irish Revenue is expected over the coming weeks which should provide additional clarity as to the practical application of the rules.

ATAD I - Interest Limitation Rules

The interest limitation rules will be of most relevance to leveraged companies operating in Ireland with a significant annual interest expense (such as an Irish S.110 company). In contrast, the ICAV, being a tax exempt entity (and typically equity funded), does not make tax deductible payments therefore regulated structures are unlikely to be adversely impacted by these rules.

The ATAD provides for a derogation to January 1, 2024 where the existing rules of a Member State are "equally effective" in preventing tax avoidance. Almost immediately, Ireland notified the EU Commission of its intention to avail of this derogation. The EU initially challenged Ireland's basis for seeking the derogation and, when Ireland failed to introduce the rules with effect from the start date of 1 January 2019, the EU Commission issued a letter of formal notice to Ireland requiring the implementation of the measures and has also commented infringement proceedings against Ireland in relation to the delay.

While no formal announcement has been made by Ireland in this respect, it is widely accepted that the interest limitation rules will form part of Finance Bill 2020, with application from January 1, 2021. The normal expectation would be that a formal public consultation into the implementation of the rules would be launched by the Irish Department of Finance, followed by a detailed Feedback Statement outlining the approach to be adopted and, finally, draft legislation in the Finance Bill in October later this year. However, in light of the COVID-19 pandemic, these timelines will need to be closely monitored.

Tax reporting/transparency

There are also increased demands for transparency and reporting fuelled by the compliance obligations imposed by FATCA and CRS reporting, and these are likely to grow with the adoption of mandatory reporting of certain cross-border transactions under the EU regime (commonly referred to as DAC6) this year. Irish Finance Bill 2019 introduced the primary legislation necessary to transpose the provisions of DAC 6 into the Irish tax code. While the Irish legislation has aligned the domestic rules very closely to the DAC 6 Directive, it has introduced some additional clarity by leveraging the definitions contained in existing domestic legislation, relating to the meaning of "tax advantage" and "arrangements". Albeit the legislative clarifications are welcome, considerable uncertainty remains with respect to the correct application and interpretation of the rules, given the ambiguity included within the DAC 6 Directive itself.

Consequently, the content of the supplementary guidance notes that we expect to issue in the coming weeks will be very important in aiding the interpretation and application of the rules in an Irish context.

Multilateral Instrument ("MLI") and the Principal Purpose Test ("PPT")

Arguably, one of the most significant changes introduced by the MLI under the BEPS Action Plan is the introduction of a PPT into Ireland's DTTs. Despite the OECD commentary and draft guidance released to address the relevant issues for non-collective investment schemes, significant uncertainty remains, and there is uncertainty in the market about how treaty partners intend to interpret and police the PPT.

In an effort to future proof investment platforms, asset managers have moved to put boots on the ground and establish their substance in the same jurisdiction as their asset owning entities. Ireland's reputation as a hub for alternative investment platforms has proved helpful in this context. Access to EU distribution channels and a well developed eco-system of servicing capabilities has helped to substantiate the use of an Irish platform in this context.

Participation Exemption for dividends

With the introduction of the MLI into legislation, and aforementioned resulting substance and product alignment, a fit for purpose holding company regime is crucial to the continued success of the Irish market. It is necessary that Ireland has a product suite that caters for all asset classes to service the needs of asset managers who are seeking to consolidate their product offering into one jurisdiction. For these reasons, there has been a concerted effort by industry to lobby policy makers to modernise certain aspects of the existing regime. Previously, discussions involving the introduction of a Participation Exemption regime in Ireland were rejected in the absence of any corresponding anti-avoidance rules such as a Controlled Foreign Company ("CFC") regime or thin capitalisation rules. Given that we have now introduced a CFC regime in Ireland in accordance with the provisions of ATAD, this lack of anti-avoidance position is no longer relevant. This position is supported by the recommendations set out in the independent review of the Irish corporate tax code carried out in 2017.

On foot of **these submissions, the Irish Department of Finance** have indicated that they will launch a public consultation on this matter later this year. It is hoped that this, together with Irish Limited Partnership reform, will enhance Ireland's product offering and ability to service the private equity market.

Overseas Deep Dive: Ireland Cont.

Irish Limited Partnership Reform

Albeit tax efficient in its current form, significant changes are expected to Irish limited partnership law that, if enacted, will offer increased opportunity to use regulated ILPs. Enactment by the Government of the Investment Limited Partnerships (Amendment) Bill is expected, which it is hoped will provide for an enhanced ILP offering and greater flexibility than that afforded under the current ILP rules. The legal amendments seek to align the ILP with similar structures in other international fund domiciles and, in doing so, to make the ILP more attractive for managers to establish their funds in Ireland.

While the referenced Bill had progressed to an advanced stage in the Irish legislative process, the change in Irish Government and more recent COVID-19 pandemic has stalled things somewhat. However, Irish policy makers remain engaged and we are hopeful for swift enactment of the Investment Limited Partnership (Amendment) Bill on return to business as usual activities.

BEPS 2.0

Finally, as the OECD continues the development of the “BEPS 2.0” project, it will be important to monitor how these proposals will impact the Irish funds industry. Based on a two pillar approach, BEPS 2.0. seeks to redefine how taxing rights are currently being allocated, while simultaneously applying a minimum effective global tax rate on groups that exceed certain de minimis thresholds.

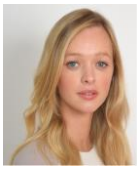
As BEPS 2.0. is largely focused on large multinational companies, its applicability in a funds context is yet to be ascertained. Ireland is acutely aware of the potential impact of Pillar 1 given the importance of multinationals and FDI to the Irish economy. As both a multinational and financial services hub, Ireland is uniquely placed to understand how the proposals are likely to impact both sectors. As a result, Irish policy makers are actively engaged in the process and continue to liaise with both industry and their global peers to ensure any proposals are given adequate consideration.

Next steps for Alternative Investment Funds

The unprecedented rate of change in the international tax environment is undoubtedly causing headaches for Alternative Investment Funds. While much of the referenced tax reform was not designed specifically to target the Alternative Investment Fund sector, the industry is being significantly affected because of the multi-tiered, widely held nature of investment structures.

Countries such as Ireland need to remain agile and innovative to meet the needs of alternative asset managers while also meeting minimum standards mandated by EU/OECD tax reform. There is no “one size fits all” approach and now, more than ever, a full suite of products is needed to allow asset managers run different strategies and deals out of alternate and tailored investment structures. We look forward to keeping you up to date as to how Ireland is managing to walk this tightrope in future editions. Feel free to contact us if you have any further questions or require assistance.

Colin Farrell
International Tax Partner
M: +353 (0)86 0867302
E: colin.d.farrell@pwc.com



Laura McKeown
International Tax Senior Manager
M: +353 (0)87 1368476
E: laura.mckeown@pwc.com

Contacts

For additional information please contact:

Marc Susgaard-Vigon
Partner
M: +44 (0) 7795 222478
E: marc.susgaard-vigon@pwc.com

Robert Mellor
Partner
M: +44 (0) 7734 607485
E: robert.mellor@pwc.com

Fiona Carpenter
Partner
M: +44 (0)7818 016620
E: fiona.carpenter@pwc.com

Malcolm Collings
Partner
M: +44 (0)7702 678205
E: malcolm.j.collings@pwc.com

Darren Docker
Partner
M: +44 (0)7761 823601
E: darren.m.docker@pwc.com

Leo Humphries
Partner
M: +44 (0)7802 659271
E: leo.humphries@pwc.com

Christine Cairns
Director
M: +44 (0)7974 207708
E: christine.cairns@pwc.com

Richard Williams
Partner
M: +44 (0)7725 632540
E: richard.x.williams@pwc.com

Jonathan Page
Partner
M: +44 (0)7876 446492
E: jonathan.page@pwc.com

Lachlan Roos
Partner
M: +44 (0)7738 311271
E: lachlan.j.roos@pwc.com

Editorial team

Pooja Thakrar
Senior Manager
M: +44 (0) 7483 448389
E: pooja.thakrar@pwc.com

Amit Singh
Manager
M: +44 (0) 7843 330331
E: s.k.amit@pwc.com

Dan Heineman
Associate
M: +44 (0) 7483 424124
E: daniel.h.heineman@pwc.com