IRISH FUNDS INDUSTRY ASSOCIATION

Sent by email: bepsconsultation@finance.gov.ie

OECD BEPS Project in an Irish Context – Public Consultation
Fiscal Division,
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2.

18th July 2014

Re: Public Consultation – OECD BEPS Project in an Irish Context

Dear Sirs,

The Irish Funds Industry Association ("IFIA")

The Irish Funds Industry Association (IFIA) is the industry association for the international investment fund community in Ireland, representing custodians, administrators, managers, transfer agents and professional advisory firms. Ireland is a leading centre for the domicile and administration of collective investment vehicles ("CIVs"). As the leading international funds centre, there is in excess of €2,800 billion of assets in over 12,700 CIVs administered in Ireland as of April 2014. These assets are comprised of €1,421 billion in 5,644 Irish domiciled CIVs (including sub-funds). Additionally, the industry services €1,403 billion in non-Irish CIVs administered in Ireland. As such all developments in the European and Global investment funds arena are of particular interest and relevance to the Irish industry.

Over the last 25 years, Ireland has developed a world-leading position as a jurisdiction for the administration and domiciling of internationally distributed investment funds. With more than 13,000 people employed in the administration, custody and servicing of funds, this sector within the international financial services environment remains the single largest sector by employment. In recent years we have seen an increasing number of jurisdictions seek to position themselves as domicile and servicing centres for investment funds and compete with established funds centres such as Ireland and Luxembourg. This increased competition, more so than before, necessitates the industry to continue to evolve and innovate to ensure both the product and service offerings available from the jurisdiction are attractive and add value for both our clients and the end investors. Recent initiatives to support these objectives include the prompt transposition of the Alternative Investment Fund Managers Directive[1] ("AIFMD") into domestic legislation, which ensured an AIFMD compliant product offering was immediately available to clients of the jurisdiction. Additionally, work is nearing conclusion on the legislation for the Irish Collective Asset-management Vehicle ("ICAV"), which will create an investment company structure that reflects the specific needs of investment funds. These initiatives further develop and enhance the funds industry in Ireland and, as a consequence, promote employment and business opportunities in the State.

[1] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

Response to the BEPS Public Consultation

Overview

The IFIA welcomes the opportunity to comment on the BEPS Project through the public consultation process. We endorse the submission made by the CHG Tax Co-ordination group on the Consultation Document. This letter sets out in greater detail some of the topics in that submission and the importance of those specific issues to the Irish funds industry.

We recognise the importance of the BEPS project arising from the compelling need by Governments to address on a coordinated basis various important tax concerns in respect of multi-national enterprises operating across multiple tax jurisdictions. The OECD has been given a mandate by the G20 to address all BEPS issues within an extraordinarily short time frame. However, it is critically important that, despite the short timeframes, the final output from the BEPS project be targeted and balanced by reference to the risks raised and not inadvertently impact on a broader base of economic activities and/or constituents.

In addition, we acknowledge and welcome Ireland's active involvement in this project and we are committed to providing assistance and support on any issues which may arise during this process. Ireland, as a small open economy, requires a balanced and targeted conclusion to the BEPS project including a consensus based outcome, avoiding harmful unilateral actions by national governments.

Collective investment vehicles ('CIVs') are designed for public participation and regulated to allow investors invest money alongside other investors in order to benefit from lower costs, professional investment management, access to markets that would otherwise be closed to small investors, economies of scale and asset/risk diversification. Considering the stated aim of the BEPS Project is to address gaps and opportunities open to multi-national enterprises to artificially shift profits resulting in double non-taxation or unduly low taxation, we believe it is not appropriate that the actions arising out of the BEPS Project should apply (either inadvertently or otherwise) to CIVs. In particular, as Irish funds invest and are distributed on a global basis it is critical that no barriers to cross-border investment and distribution are created by the BEPS Project resulting in either double taxation or unduly high taxation.

Ireland's Tax Regime

The Irish tax regime is at its core, competitive, transparent and certain and we believe would stand up to any scrutiny that may arise during the BEPS process. Ireland's top rating in the Global Forum for Transparency and Exchange of Information for Tax is a strong demonstration of this. We feel it is critical, both during the BEPS process and in a post-BEPS environment, that Ireland ensures that the tax regime remains competitive, as this will foster investment, innovation and growth in our industry which will ultimately be of benefit to the economy and society as a whole. The BEPS Project raises both serious concerns for our industry in certain areas but also raises opportunities which need to be grasped in order to ensure Ireland's offering remains competitive in a post-BEPS environment.

Key Concerns from BEPS Project for Irish Funds

The key issues and concerns arising in the BEPS process to date are as follows;

1. The lack of clarity on how CIVs will be dealt with in the proposals on Action 6 (Granting of Treaty Benefits in Inappropriate Circumstances).
2. Certain elements of Action 2 (Hybrid Mismatches) potentially impact the way CIVs legitimately manage investment portfolios.
3. The uncertainty around national governments reaching a consensus on key issues and the risk of governments taking unilateral actions adversely impacting small open economies like Ireland's.

Opportunities in a post-BEPS Environment

In the post-BEPS environment, it is likely that the generation and taxation of profits will be more stringently linked to where the economic activities are carried out. As a result, in order for Ireland to maintain its attractiveness as a domicile of choice for CIVs and a location for asset managers to maintain and grow key parts of their businesses, a tax environment must exist that fosters investment, innovation and growth to ensure these activities can be undertaken in Ireland. In this regard, we feel opportunities exist to tailor Ireland's tax regime to adapt to new post-BEPS environment including:

1. Create a tax environment encouraging the location of senior decision-makers including appropriate incentives to attract the right calibre of person. We have made submissions on the Special Assignment Relief Programme and Carried Interest with a view to putting Ireland forward as a real proposition for fund managers to locate senior decision makers.
2. The introduction of new incentives and extension of existing incentives in relation to intellectual property including extending the R&D credit regime, deductions for goodwill/know-how and the introduction of an income based incentive.

Consultation Questions

Question 1; Which of the international tax issues identified in the BEPS Action Plan would need to considered the highest priorities for Ireland for examination with a view to action?

BEPS Action 6 – (Treaty Abuse)

The public discussion draft on Action 6 (Preventing the granting of treaty benefits in inappropriate circumstances) raises some very real concerns for the Irish funds industry. We refer to our detailed submission to the OECD dated 8 April 2014 (copy attached) setting out our concerns including the impact on treaty access for collective investment vehicles ('CIVs') and, in particular, the material adverse impact to Irish funds which service cross border investor needs compared with their counterparts in larger jurisdictions which predominantly service local/domestic investor needs.

Treaty access is of fundamental importance for CIVs as withholding taxes on income and capital gains impact the fund performance and ultimately investors. The lack of treaty access for CIVs will create double taxation for investors with no ability for the investor in most cases to claim a refund or obtain a credit for the double taxation suffered. This has the result of unduly high taxation for the investor compared to investing directly into the assets.

We note that the OECD indicated that the provisions included in the public discussion draft in relation to the Limitation on Benefits were not intended to be a mechanism to deny treaty benefits for CIVs. We further understand that the 2010 OECD CIV Report (The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles) will be referred to as the approach to be adopted in dealing with treaty access for CIVs.

However, we have not yet seen any confirmation as to how this approach on dealing with CIVs will be incorporated into the Limitation on Benefits provisions. In this regard, we would like to understand:

1. The detail as to how CIVs and the 2010 CIV Report will be dealt with in the revised Limitation on Benefits provisions and how this will be incorporated into the multi-lateral agreement?
2. In a post-BEPS environment, how is it envisaged that Irish CIVs will be entitled to claim treaty benefits and how will that be applied in practice?

For those investment funds not falling within the definition of a CIV, it is important that a 'derivative benefits' provision be included in the Limitation on Benefits clause. A practical and workable 'derivative benefits' clause which is broad based and in line with EU law is important for any fund centre that services cross border investor needs.

In addition, the public discussion document includes a general anti-abuse rule (GAAR) allowing tax authorities deny treaty benefits where one of the main purposes of a transaction or arrangement is to obtain a more favourable tax treatment. We believe it key that any GAAR provisions should specifically recognise the provisions of the 2010 CIV Report and also recognises that investors utilising unconnected widely held CIVs for professional investment management should not be considered to be entering into a transaction one of the main purposes of which is to secure a benefit under a tax treaty.

BEPS Action 2 (Hybrid Mismatch Arrangements)
Action 2 deals with recommendations on neutralising the effects of hybrid mismatch arrangements. The recommendations are broken into two parts –

(1) Recommendations regarding the design of domestic rules to neutralise the effect of hybrid instruments and entities, and
(2) Changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities are not used to obtain the benefits of treaties unduly.

We would like to draw your attention to a number of items that need to be kept in mind in focusing on Action 2 in the context of Irish regulated funds.

Irish Regulated Funds

Irish CIVs (which are governed by Section 739B TCA 1997) are technically liable to tax. In many cases, the CIVs don't pay corporate/income tax where all of the investors are non-Irish resident and have made the required tax declarations of non-residency.

CIVs include corporate and unit trust structures and are clearly tax opaque for Irish tax purposes. On that basis such CIVs are not hybrid entities and should not be seen as such i.e. other countries should also respect them as opaque.

Because most CIVs do not pay Irish tax, the fact that other jurisdictions may categorise them as "tax exempt" should still not draw them within the scope of Action 2 i.e. they should not be considered a hybrid arrangement as they are not a hybrid entity. It is important that Ireland is clear in this respect.

In the context of CIVs that are not tax opaque such as the tax transparent Common Contractual Fund (CCF) and Investment Limited Partnership (ILP), we see BEPS as an opportunity for Ireland to reiterate the tax transparency of these structures to ensure that they could not be considered hybrid entities. The BEPS Project also provides an opportunity for Ireland to proactively seek recognition with other tax authorities on the tax transparent nature of these CIVs which is also helpful in the wider cross border marketing of such CCFs and ILPs.

Efficient Portfolio Management

A hybrid arrangement can also arise in the context of hybrid instruments. In this regard, CIVs can make use of securities lending and repo transactions where it is appropriate for Efficient Portfolio Management ('EPM') purposes including, inter alia, the hedging of risks and managing liquidity. Such use of EPM has to

be disclosed in the prospectus of the CIV and permitted in the authorisation given to the CIV by the Central Bank of Ireland. It is important to note that where CIVs enter into such stock lending and/or repo transactions with income/expenses in relation to such transactions included in their profit and loss account, we would not consider the transaction to be a hybrid just because the income/expense in the CIV would not be "taxable/deductible" under Section 739B. Therefore while a stock lending/repo transaction could be considered a hybrid instrument, it should not be considered so purely because the counterparty is a CIV. While there are helpful commentaries in the draft proposals, such that hybrid mismatches should not arise only because of a particular feature/characteristic of a taxpayer (e.g. a charity), we would want to ensure that similar treatment was afforded to a CIV.

In looking at stock lending/repo transactions and assuming that they could be considered hybrid (though not because of the CIV counterparty), there are some practical difficulties such as;

1. If there are situations in other countries where repos were giving rise to tax credit generation as outlined in BEPS action 2, then clearly it should be the responsibility of those particular jurisdictions to address any concerns rather than Ireland.
2. Identification of related party transactions in the context of CIVs which are very often widely held. We appreciate that various initiatives (e.g. FATCA, EU Savings Directive, country by country reporting etc.) all try and address the identification of the ultimate beneficial owner. In the context of the fund entering into a transaction, any suggestion that there would be a 10% (or even expanded to a 25%) related party rule would be unworkable. Again we would highlight that any repo/stock lending transaction is only permitted where the CIV includes same in their prospectus and for EPM purposes.
3. We note in clause 122 of the draft proposals on the design of domestic rules that the hybrid financial instrument rule should apply to all instruments held by related parties (including persons acting in concert) regardless of whether the instrument is "widely held". We would reiterate that this isn't practical in a CIV context.
4. Whilst some of the recommendations in Action 2 are to the deny deductions for payments made under the hybrid financial instrument, and arguably where the CIV is the recipient to include the amount as income in the accounts and in the tax return, one needs to be mindful of the specific tax status of CIVs (as they won't effectively be taxing a receipt or obtaining a deduction for the cost under Irish tax law). Clause 93 of the proposals is helpful in that it reiterates that "a payment will be deductible even if the entity incurring the expenditure is exempt from tax and does not benefit from the deduction..". However it would be important to ensure the same recognition is afforded to CIVs given their particular characteristics.
5. We would also note that a "bottom up" approach as outlined in the Draft Proposals seems a more pragmatic approach rather than the "top down" approach.

Treaty Considerations

While relevant to the overall treaty consideration, we would not be in favour of the management and control test being abandoned in the context of the residency definition for treaty purposes.

Question 2; Are there other current international tax proposals that would be of concern to Ireland?

A continuing concern to CIVs managed and administered in Ireland is the requirement to comply with the comprehensive and increasing body of legislation which governs the industry. It is acknowledged that such compliance is necessary and indeed desirable.

In addition, however, to whatever increased requirements will result from the BEPS project, CIVs must also address their obligations under the recent initiatives, including;

1. The enhanced EU Savings Directive adopted on 24 March 2014;
2. The OECD Common Reporting Standard ('CRS') adopted in February 2014; and
3. The EU Directive on Administrative Co-operation which came into effect in January 2014.

Such additional obligations are supplementary to any impact that the EU Commission's proposal on Financial Transaction Tax and/ or FATCA may have on CIVs based in Ireland.

We believe that it would be helpful if all requirements dealing with the automatic exchange of information ('AEOI') on financial accounts are consolidated or streamlined as far as possible. In particular, if the CRS devised by the OECD becomes the global standard for AEOI it is critical that EU reporting requirements on financial accounts (e.g. European Union Savings Directive) are either repealed or realigned with the CRS. Other proposals that are of concern are highlighted in the CHG Tax Co-ordination group submission.

Question 3; In a changing international environment, what's the best way for Ireland to ensure that its taxation provisions, for example in relation to intangible assets, are competitive?

Introduction

Given the competitive global environment in which we currently operate, there is pressure on governments to constantly look at their offering to ensure that they remain competitive. In the asset management industry there has been significant regulatory change and this change continues to evolve. This results in changes in the way we operate from a business perspective and requires us to ensure that our tax legislation is current and fit for purpose. It is essential that the Government and industry continue to have an open and collaborative approach to bringing about tax changes that are robust, competitive and appropriate to the future of the Irish Asset Funds Management industry.

Ireland's corporate tax regime has always been seen to be the cornerstone of attracting international business investment. Key to success has been to offer a transparent message to the international business community. Maintaining this approach is essential to the continued development and competitiveness of Ireland's business tax offering. But it is not enough.

SARP/Carried Interest

One of the areas that the BEPS Report has focused on is substance, not only from a transfer pricing perspective but also in the context of establishing entitlement for double tax treaty purposes. We have also seen this issue arise in UCITS IV and, more recently, AIFMD debates where fund managers are looking strategically at where they are going to locate, grow and maintain key parts of their businesses. There is also a strong link to locating potential future fund structures in the jurisdiction where such fund management businesses locate. It is clear that from the regulatory changes (and not lost in the BEPS debate) that more focus is being placed on location of senior decision-makers and in this regard, appropriate incentives to attract the right calibre of person is essential if Ireland is to have any real chance of success in this area. As a result, in the industry's submissions on the Special Assignment Relief Programme and Carried Interest we have sought to address the shortcomings in this area with a view to putting Ireland forward as a real proposition as far as fund managers are concerned.

It should be borne in mind that other countries have already put forward very favourable employment incentives for fund managers to locate there. We have seen the positive effect in Ireland of reducing the

corporate tax burden. However, with the pressure on traditional manufacturing industries to relocate to low cost economies, there is more and more focus on reducing the overall personal tax burden to improve the growth potential within the service sector. Key to this is an offering that will attract senior personnel and decision makers to relocate to Ireland, which should lead to real employment growth opportunities as they build their teams and business locally.

Innovation
One of the traditional areas of focus of international tax regimes is to reward innovation and create a tax environment that encourages, at the very least, entrepreneurship. It encourages businesses to invest in the future development and “rewards” through appropriate tax incentives. The competition among governments to attract such research investment has escalated in recent times as a result of global business expansion and transformation, attributable in the main to technological advances. The historic focus of incentives towards front-end expenditures has now evolved towards the use of income-based incentives, such as patent box regimes. Such regimes have been under scrutiny under the BEPS process. However, in the event that such regimes are acceptable internationally and deemed suitable post EU review, we believe that such incentives should be strongly considered by the government in the context of attracting appropriate foreign direct investment.

The question of what type of R&D qualifies for relief should be strongly considered. What constitutes business in one industry is likely to be very different in the context of other industries. Within the asset management industry, product innovation is a key business driver. Relief for expenditure on such innovation and/or the income arising from such innovation is not sufficiently provided for under Irish law. Appropriate incentives for product innovation in the fund industry and asset management sector present a real opportunity for attracting substance and employment to Ireland.

Research &Development (‘R&D’)
Consideration should be given to the expansion of the R&D credit for product development, linked to employment commitments, in the areas of idea generation on new innovative products covering research and investment using criteria such as:

- Has there been an investment of time on developing the project?
- Has there been a Financial Investment including employment commitments?
- Is there a Risk of Loss/Failure?
- Is there innovation/incubation?

Perhaps legislation could be drafted where after any successful product launch (define criteria) the R&D credit is repaid over subsequent number of years?

Goodwill/Know How Deduction
To encourage the location of asset management operations to the jurisdiction consideration should be given to a deduction for any goodwill acquired. This would include moving management contracts here or moving key functions such as risk management, investment management, product development, trading platforms or investment analysis operations. The deduction could be availed of by following accepted accounting treatment for goodwill. Consideration should also be given to allowing this on transfer from related parties in other jurisdictions.

IRISH FUNDS INDUSTRY ASSOCIATION

Question 5; What are the critical considerations in shaping Ireland's response to current international tax developments—either in general or with respect to particular issues?

We have set out below what we view as the key considerations for Ireland in the context of the current and future developments in international tax:

1. Ireland needs to respond in a timely and appropriate manner to such developments. This requires that no unilateral actions are taken until there is certainty in a post-BEPS environment.
2. The relevant officials should have a clear understanding of the issues impacting on industry. The IFIA would welcome the opportunity to work with the appropriate persons to ensure that all parties have a full understanding of the concerns of our industry.
3. It is necessary to take a proactive approach to Ireland's tax regime and consider how changes will impact the wider economy. A key aspect of such a proactive approach is to have pre-emptive engagement with industry in advance of any actions.
4. A business friendly environment requires a tax regime that can respond to changes in the requirements of industry. This includes a need for the tax regime to adapt to regulatory changes as quickly as possible. Any changes to the tax regime should be considered in tandem with regulatory changes.

Question 6; Are there any other priority areas or future challenges that should be considered as part of this process?

We have identified the following as priority considerations:

1. Early engagement with industry on the multi-lateral agreement is essential.
2. All BEPS action points should be reviewed and considered together now (including 2015 actions) and industry consulted.
3. Strengthening of Ireland's double tax treaty network; this involves enhancing existing treaties and further engagement to secure treaties with key jurisdictions for the Irish economy e.g. Brazil.
4. In a post-BEPS environment, the relevant bodies should be more comfortable in considering and approving new products. We would hope that this will enhance Ireland's competitiveness.
5. The OECD has set a very ambitious timeframe on matters that require careful thought and consideration. There is a risk that pushing through on delivering in the timeframe puts the project at risk of failure or unintended damaging consequences.

Summary

The IFIA welcomes the opportunity to comment on the BEPS Project through the public consultation process. As described above there are aspects of the BEPS Project which are of deep concern to our industry specifically the provisions of Action 6 which may eliminate the ability for Irish CIVs to access tax treaties and/or practically obtain relief under tax treaties and Action 2 impacting genuine effective portfolio management which is a key tool used by CIVs to both protect investor returns and manage investment growth.

The BEPS Project is focusing on attributing profits and income to where key decisions are made and where commercial activities are undertaken. We have identified certain ideas and topics which we feel should be given appropriate consideration to ensure that Ireland has a tax regime which remains competitive in a post-BEPS environment ultimately leading to investment and growth in the funds/asset management industry and the economy as a whole.

IRISH FUNDS INDUSTRY ASSOCIATION

We would welcome the opportunity to further discuss the contents of this submission through the public consultation process.

Yours faithfully,

Pat Lardner
Chief Executive