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ACTL Conference

Taxable and Transparent Investment structures

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Agenda

1. Setting the scene: taxable structures in the RE fund environment
2. BEPS: need for change!
3. The future: modifying what we have or building something new?
4. Growing market for CIVs and REITs

Setting the scene

Fund types and investment focus

REITs	Generally listed corporate entities investing in income producing real estate. Effectively **tax exempt**, taxation of dividends at shareholder level. Foreign investments, typically held through **taxable asset owning entities**.
CIVs	Non-listed – often open end - pooling vehicles for (institutional) investors from one jurisdiction mostly investing in same territory. **Tax transparent or tax exempt**. Taxation at investor level (unless investor is exempt).
Private Equity RE Funds	Non-listed - closed end - pooling vehicles of institutional investors from multiple territories investing in one or more territories. Typically structured through **taxable asset owning companies** held by a transparent or exempt fund vehicle.

Setting the scene

Investor types

Private individuals

Tax exempt investors:

- Pension funds
- Charities
- Sovereign Wealth Funds

no CIT if investing directly

Fund of funds (CIVs)

Life insurance companies

Tax neutrality private and collective investments
Mission impossible?

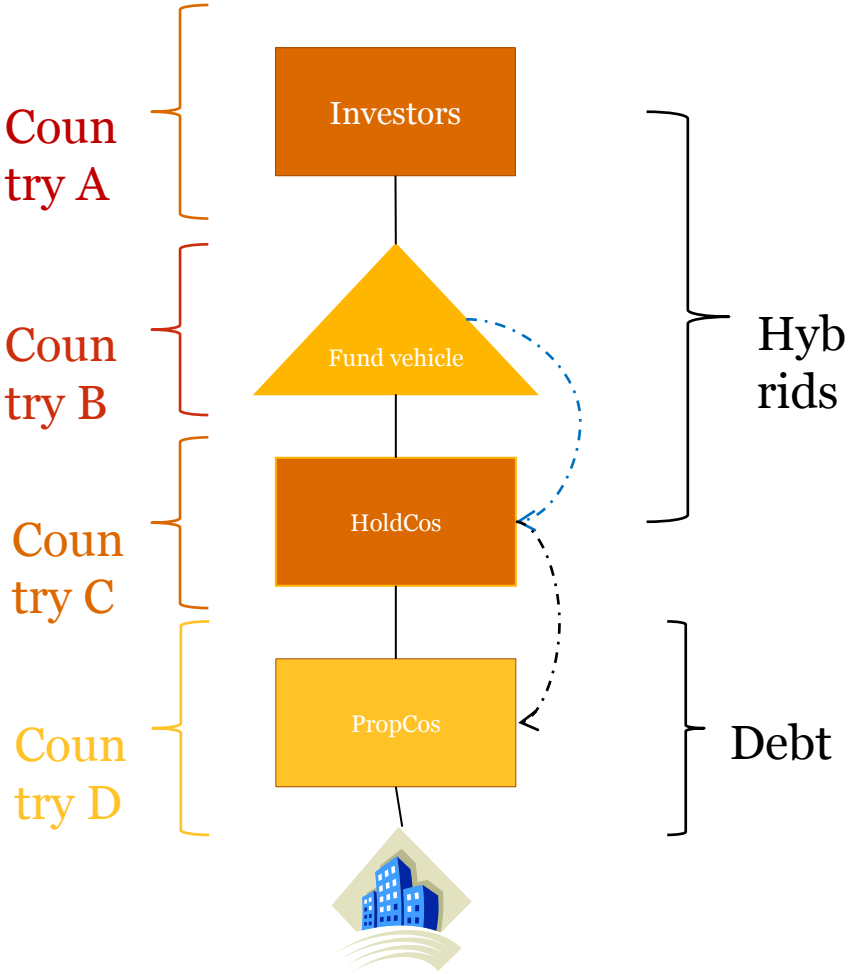
- Tax leakage at fund level impacts tax neutrality and harms the fund's business case
- REITs and CIVs investing in RE in home country sourced by equity of home country investors generally results in full tax neutrality
- Foreign investors in REITs and CIVs impact neutrality if taxation of income differs from source state taxation in case of direct investment
- Foreign investments by REITs and CIVs generally impact neutrality. By accepting the exemption of REIT/CIV the source state would lose right to tax RE income
- X-border investments typically end-up in a taxable structure to avoid qualification conflicts while maintaining low effective tax leakage

Taxable investment structure

Achieving tax neutrality in a taxable structure

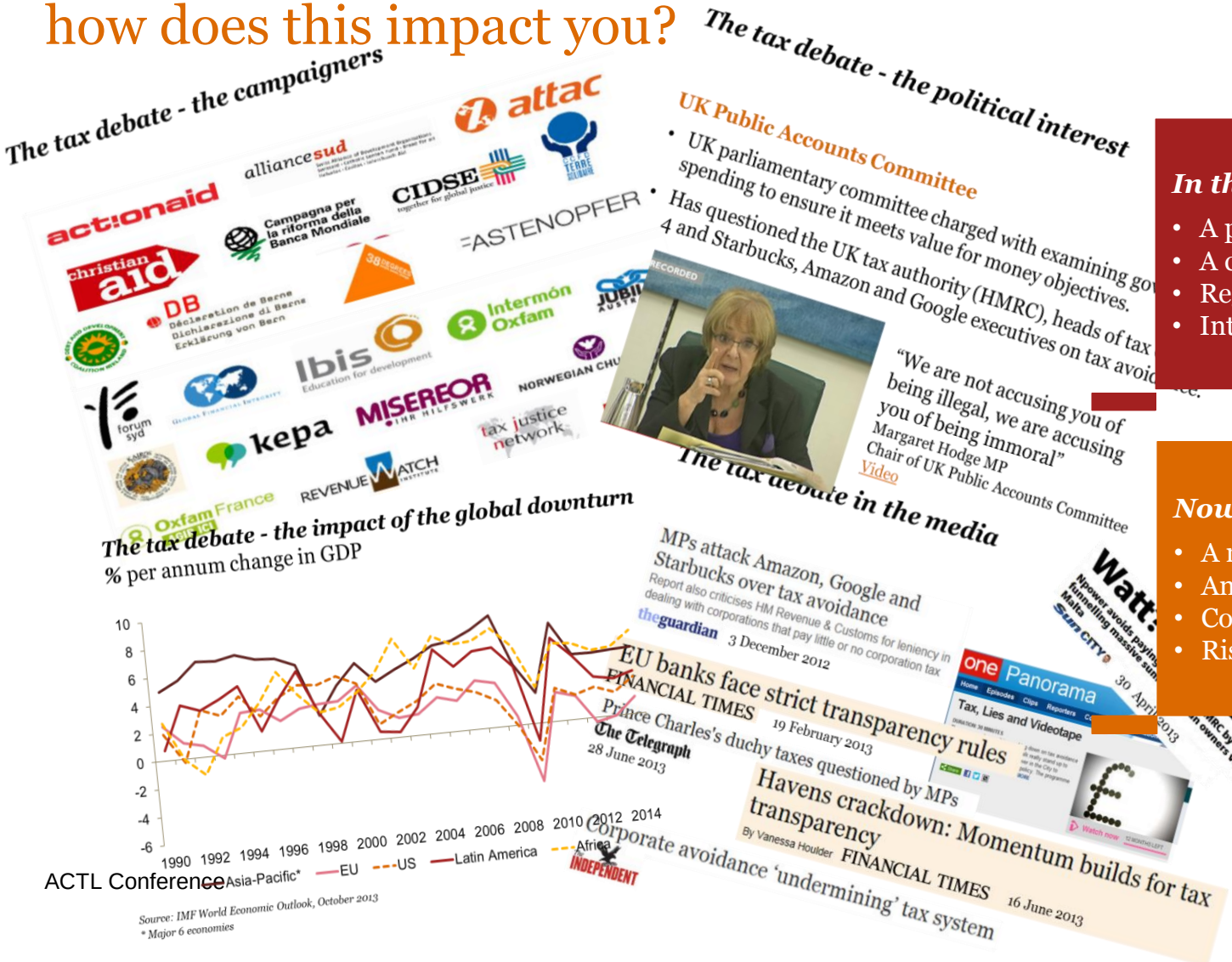
How does it work?

1. Investors not subject to CIT
2. Pooled investment vehicle – the CIV or REIT
3. Holding platform – the use of intermediate holding and financing companies.
4. Leverage - the use of debt:
   a) Hybrid instruments;
   b) Interest bearing loans.
5. Deductibility of interest.
6. Profit repatriation:
   a) Maximising interest;
   b) Dividends.



The public debate on 'tax fairness'

Global investors are increasingly being challenged on tax - how does this impact you?



In the past, tax was:

- A private financial matter
- A cost to be managed
- Regulatory compliance
- Interpretation of the law

Now, tax is also:

- A reputational issue
- An investment in society
- Corporate responsibility
- Risk management

BEPS and Real estate funds

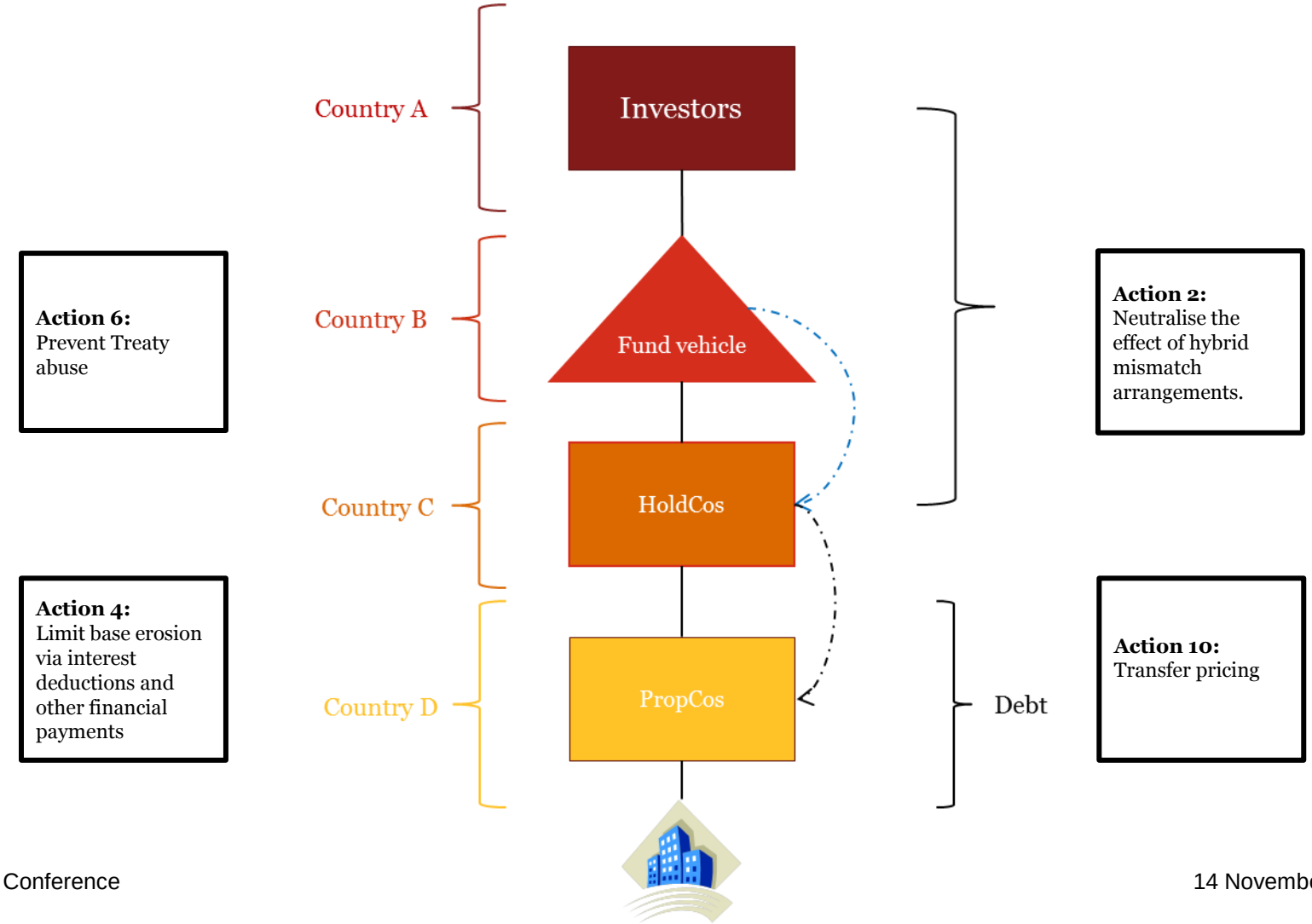
The perfect storm?

The BEPS action plan

Impact on taxable real estate funds

ACTION 1: Address the challenges of the digital economy	**ACTION 2:** Neutralise the effect of hybrid mismatch arrangements	**ACTION 3:** Strengthen CFC rules	**ACTION 4:** Limit base erosion via interest deductions and other financial payments	**ACTION 5:** Counter harmful tax practices more effectively, taking into account transparency and substance
ACTION 6: Prevent treaty abuse	**ACTION 7:** Prevent the artificial avoidance of PE status	**ACTION 8:** Assuring that TP outcomes are in line with value creation **Intangibles**	**ACTION 9:** Assuring that TP outcomes are in line with value creation **Risks & capital**	**ACTION 10:** Assuring that TP outcomes are in line with value creation **Other high-risk transactions**
ACTION 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it	**ACTION 12:** Require taxpayers to disclose their aggressive tax planning arrangements	**ACTION 13:** Re-examine transfer pricing documentation	**ACTION 14:** Make dispute resolution mechanisms more effective	**ACTION 15:** Develop a multilateral instrument

Are these structures sustainable in the light of BEPS?



From taxable fund structures to CIVs and REITs

Fund structures – the next generation?

1. Reduce / remove reliance on treaties?

2. Design structures that do not rely on hybrids?

3. Modifying what we have?

4. Building something new?

Modifying what we have
Actions to consider

Actions to Consider

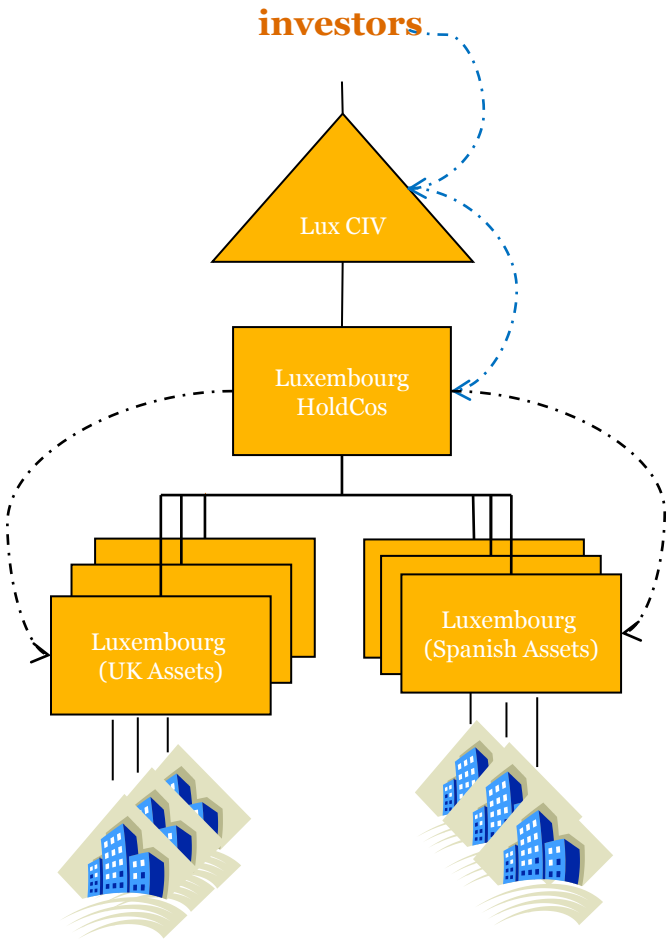
Focus on structures with adequate substance and relevant business purposes

Align substance and structure with tax requirements of the source jurisdiction

Take steps to avoid using separate holding companies for each transaction;
fewer structures with more substance will be more effective

Consider onshoring your funds to help establish substance and create cost-efficiencies

Modifying what we have
Luxembourg – the empire strikes back?



Pros

1. No local PropCos so withholding tax on dividends not in point.
2. No withholding tax on interest under Luxembourg domestic law.
3. Transparent fund structure to mitigate withholding tax at HoldCo level.
4. Single territory with regulated fund improves business purpose.

Cons

1. Base erosion measures may increase CIT base.
2. Potential residence / permanent establishment issues should be considered
3. Commercial issues on exit?

Building something new?
Non-resident investor claims resident treatment

Pension fund

Generally tax exempt

- European Commission, White Paper 16.2.2012 COM(2012) 55)
- Centro di Musicologio Walter Stauffer C-386/04
- Commission v. Finland (C-342/10, 8 November 2012.

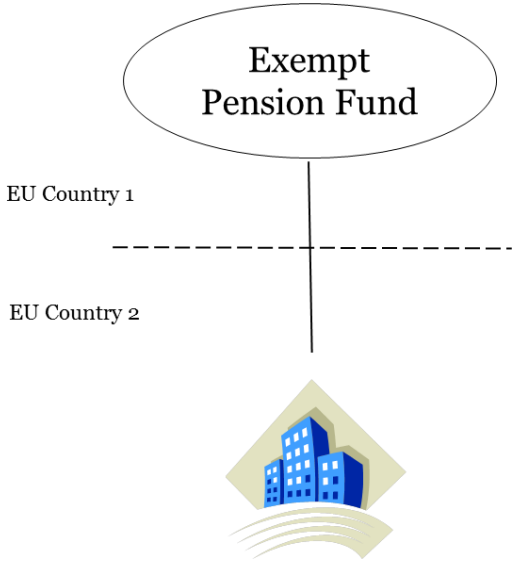
Insurance company

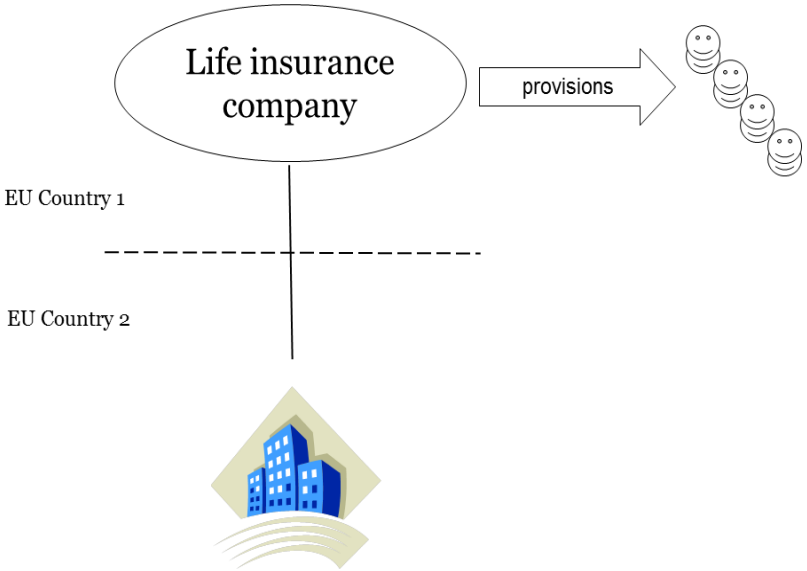
Effectively low CIT-rate due to allocation of income to technical reserves

- European Commission, White Paper 16.2.2012 COM(2012) 55)
- Memo 14/293 16 April 2014 Commission asked the Netherlands to end the discriminatory taxation of Dutch-sourced dividends paid to EU/EEA insurance companies

"The Commission will investigate whether the tax rules concerning cross-border investment returns of ***pension and life insurance providers****, including their income from real estate and capital gains present discriminatory tax obstacles to cross border mobility and cross border investments"* (European Commission, White Paper 16.2.2012 COM(2012) 55)

Building something new?
Non-resident investor claims resident treatment



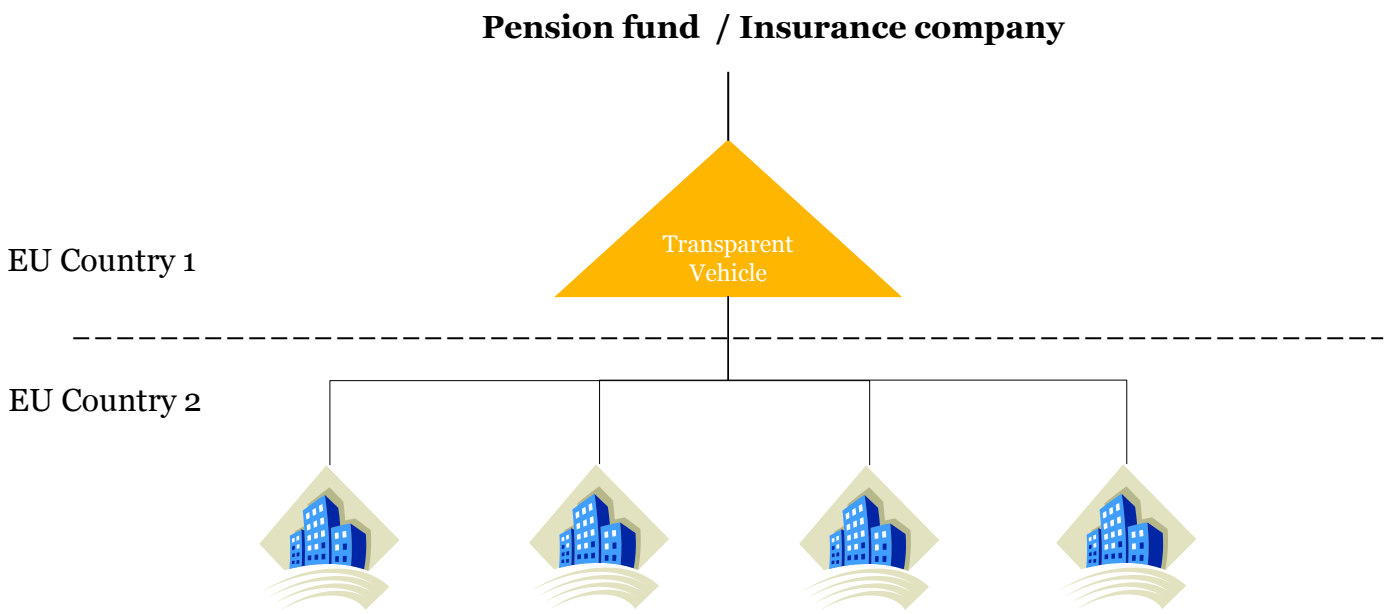


Commission v. Finland (C-342/10, 8 November 2012):

1. The aim of the (Finnish) regime is decisive and not the technique: tax exemption versus taxable -/- provisions

2. Link between investment income and provisions is deemed to exist if allocation to provisions is treated as business expense : no direct link required with investment income from source state

Building something new?
The transparent structure



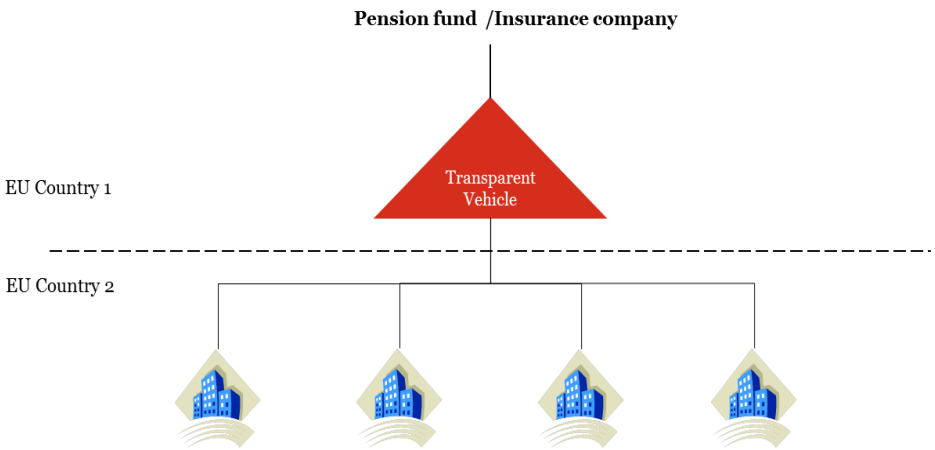
Building something new?
The transparent structure

Pros

1. The CIV is transparent for income and capital gains tax purposes
2. Investors benefit from source state exemptions

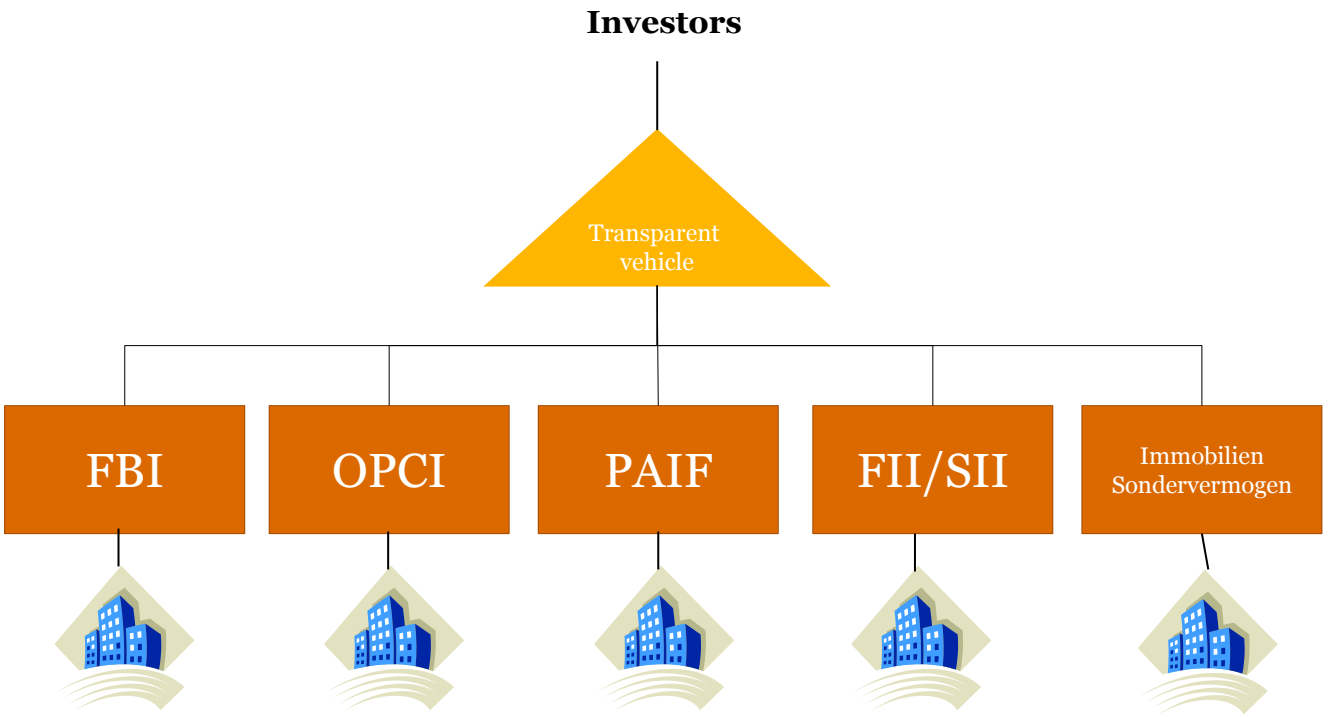
Cons

1. The fund must be transparent for the purposes of the relevant tax laws and DTT – not always clear cut.
2. Tax filing considerations – do investors need to file locally?
3. Bank / other financing issues.
4. No tax or legal blocker?



Building something new?

Invest through local "exempt" CIVs – Fund of fund structure



Building something new?

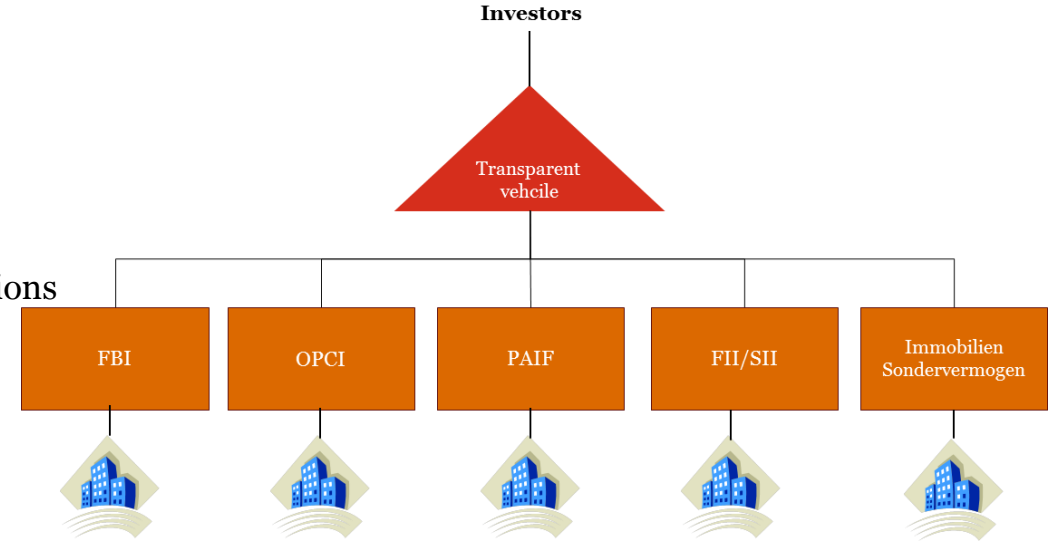
Invest through local "exempt" CIVs – Fund of fund structure

Pros

1. No qualification mismatches
2. Tax/legal blocker in place
3. No local filing obligation of investors

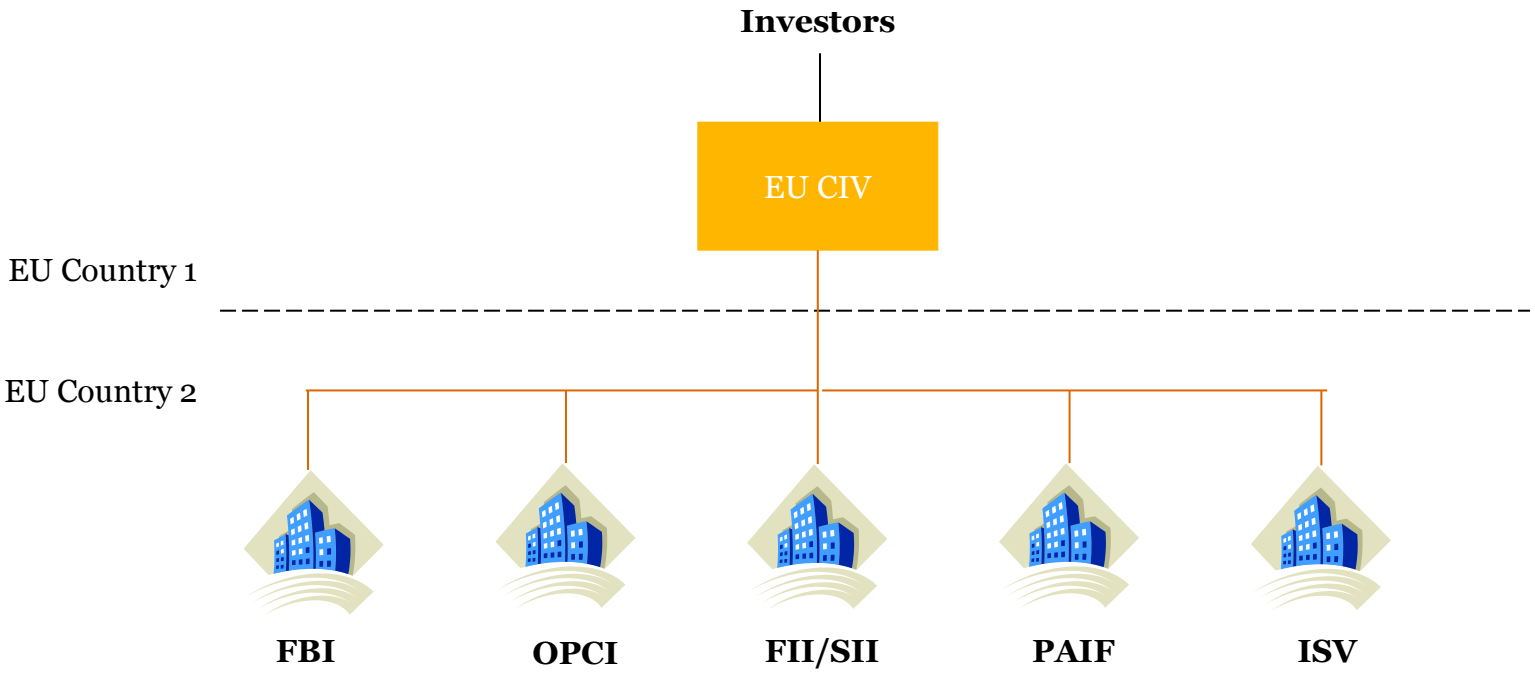
Cons

1. Regime may not allow closely held CIV
2. Regulatory compliance in multiple jurisdictions
3. Withholding tax leakage if no credit/refund
4. Activity test may not be met



The call for a simple structure!

Non resident CIVs claim local CIV regimes in source states



An overview of CIV regimes in 5 RE markets

Requirements	Legal form	Shareholder	Distribution	Financing	Investment	**Is regime available to non-resident funds?**
NL: FBI 0% CIT rate	Corporations and mutual fund	Yes	Yes, subject to 0%-15% wht	Yes	Yes	Yes
F: OPCI CIT exempt	Corporation and mutual fund	No	Yes, subject to 15%-55% wht	Yes	Yes	Under conditions
E: FII/SII 1% CIT rate	Corporations and mutual fund	Yes, 100 investors	No 21% wht on redemptions	Yes	Yes	No
UK: PAIF CIT exempt	Corporation	Yes	Yes, 0%-20% wht	Yes	Yes	No
D: (Spezial) Sondervermögen CIT exempt	Mutual fund	No	Deemed distribution, subject to 26,375% wht	Yes	Yes	No

An overview of REIT regimes in 5 RE markets

Requirements	Legal form	Shareholder	Distribution	Financing	Investment	**Is regime available to non-resident funds?**
NL: FBI 0% CIT rate	Corporations and mutual fund	Yes	Yes, subject to 0%-15% wht	Yes	Yes	Yes
F: SIIC CIT exempt	Corporations	Yes, listing	Yes, subject to 0%-30% wht	No	Yes	Yes
E: SOCIMI 0% CIT rate	Corporations	Yes, listing	Yes, subject to 21% wht	No	Yes	No, except through sub
UK: REIT CIT exempt	Corporation	Yes, listing	Yes, subject to 0%-20% wht	Yes	Yes	No
D: (Spezial) Sondervermögen CIT exempt	Corporation	Yes, listing	Yes, subject to 15,825-26,375% wht	Yes	Yes	No

The call for a simple structure!
Non resident CIVs and REITs claim CIV/REIT regime in source state

CIVs (REITs OEICs etc.)

- The ECJ ruled in 2009 in Aberdeen (C-303/07) and 2012 Santander (C-338011) that it is not compatible with the EU law to levy dividend withholding tax only on dividends paid to non-resident investment funds while exempting domestic investment funds from such taxes.
- On 16 June 2011 the EC has formally requested Estonia to amend its tax legislation as it discriminates non-resident investments funds. Resident funds are entitled to a tax exemption for real estate income, while comparable funds established in the EU are subject to tax (IP/11/718).
- On 10 April 2014, the ECJ ruled that the corporate income tax exemption was extended to investment funds in third countries (C-190/12 Emerging Markets Series of DFA Investment Trust).
- Commission v. Belgium (IP/14/1144) The European Commission has decided to refer Belgium to the ECJ for discriminatory taxation of collective investment undertakings (CIUs) established in other Member States of the EU or of the EEA.

Tax neutrality between domestic and x-border fund investments

Mission impossible?

- Source states reluctant to apply tax exemption of CIV/REITs to non-residents in order to protect the source state's right to tax RE income
- Is there a justification for the taxation of non-resident CIVs and REITs by a member state that exempts resident CIVs and REITs?
- Taxation of non-resident CIVs and REIT in excess of (withholding) tax levied from resident CIVs and REITs may be disproportionate
- BEPS may cause x-border investors and funds to explore alternative routes including their strengthened position under EU law
- Call for BEPS action plan no. 16: "The Harmonization of CIVs and REITs" !

Add closing statement here…