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European Fund and Asset Management Association

EFAMA Position Paper
Draft Anti-Tax Avoidance Directive

I. GENERAL REMARKS

EFAMA fully supports the aim of eliminating tax abuse enshrined in the draft Anti-Tax Avoidance (ATA) Directive which the European Commission published on 28 January 2016.

EFAMA is the representative association for the European investment management industry. EFAMA represents through its 26 member associations and 61 corporate members EUR 21 trillion in assets under management of which EUR 12.6 trillion managed by 56,000 investment funds at end 2015. Just over 30,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 25,900 funds composed of AIFs (Alternative Investment Funds). Our industry provides significant and stable flows of finance to the European economy.

This position paper sets the views of the European investment management industry with regards to the impact of the proposed ATA Directive on this industry, as well as on its interaction and potential impact with the OECD BEPS Action plan.

II. POLICY AIMS WITH RESPECT TO FUNDS

EFAMA understands that the ATA directive is a cross-sectoral one, and for this reason does not address specifically the particular requirements of investment funds.

EFAMA believes however that the ATA directive needs to appropriately consider the specific nature of investment funds. Only by doing this would the ATA Directive provide the necessary legal certainty.

In the current investment climate it is imperative that investors are able to diversify risks across investments and international markets. The economies of scale from investments held through investment funds give access to markets, appropriately diversified, in which investors would otherwise not be able to invest. In case small investors had to invest directly, they would incur substantial time and costs, and would have difficulties to come up with an appropriate market diversification.

It is therefore important that investment funds can operate under tax laws that give them greater certainty as to the tax impact at investment level, be it withholding tax or capital gains tax so that investors can manage their savings more effectively.

The fact that the ATA Directive does not have specific rules for investment funds leads inevitably to legal uncertainty and may have significant unintended consequences for investor outcomes. Member states, when implementing the ATA rules into national law, will have to revert to the more detailed reports of the OECD.

Before commenting in more detail on the proposed Directive, EFAMA sets out below what we believe the aims of both OECD and European tax policy should be in relation to investment funds.

1. Aims in relation to CIVs

CIVs are generally mass market investment vehicles, not presenting high risk of tax abuse, and which need simplicity and economy of operation if they are to fulfil their role of providing accessible investment. The importance of ensuring a special treatment especially with regard to treaty entitlement for CIVs has already been recognized by the OECD.

It has already been outlined in the CIV Report adopted by the OECD Committee on Fiscal Affairs on 23 April 2010 that there are a number of benefits of investing through CIVs. CIVs are an important complement to other savings vehicles. In many countries, participants, through defined contribution retirement plans invest primarily in CIVs. Because CIVs allow small investments, they are ideally suited for such periodic savings plans. They are highly liquid, allowing withdrawals as needed by retirees. With ageing populations in many countries, CIVs will become increasingly important and their relevance cannot be overstated. The 2010 CIV Report acknowledges this and intends to provide all CIV investors, regardless of how their CIV was structured or sold, with the opportunity to receive the treaty relief that they would obtain if investing directly.

As a result in case member states revert back to the OECD guidelines with respect to CIVs they will consider the specific nature of these funds. However, EFAMA believes the key provisions of the ATA Directive itself should explicitly exclude CIVs as well as similar Non-CIVs (which means widely held, no leverage and no subsidiaries) from its scope.

2. Aims in relation to Non- CIVs[1]

Non-CIV funds provide a vital source of capital to companies, particularly to small and medium businesses, infrastructure projects, property development and other essential economic activities. They are formed for the purpose of providing access to investment opportunities for a variety of investors, typically institutional investors representing retirement plans and sovereign wealth funds that are invested for a variety of non-tax reasons.

Due to the often complex structures of Non-CIVs that include several SPVs (Special Purpose Vehicles) it is very likely they will be affected by the ATA directive. EFAMA is concerned that the ATA draft Directive has not recognized the importance of this kind of funds and does not propose any exceptions.

[1] Non-CIVs are understood to be collective investment structures that do not fall under the definition of CIVs which are defined as “funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection legislation in the country in which they are established. The exact definition of Non-CIVs may differ among the member states. Typically private asset funds are likely to be considered Non-CIVs.

3. The ELTIF proposal

Due to the difficulties mentioned above with respect to Non-CIVs, EFAMA is of the opinion that an appropriate solution might be to have a new tax model for those private assets funds that fulfill predefined requirements. We would therefore refer to the Regulation on European long-term investment funds (Regulation (EU) 2015/760) and propose a tax framework which exempts EU entities owned by a qualifying vehicle from EU taxation. This would entail a tax upon distribution levied to the state of residence of the investment vehicle but no imposition of taxes on income or gains within the vehicle, and no withholding at source on income from the assets of the fund where the latter are located in an EU member state. Instead. In the short term this tax framework might apply to ELTIFs.

III. DETAILED COMMENTS ON THE DRAFT ATA DIRECTIVE

EFAMA notes that the draft ATA Directive proposes rules which are stricter than those included in the OECD BEPS Action Plan. Therefore, EFAMA has concerns whether these rules could decrease the interest of investing in companies and funds established within the EU which would have a negative impact on the competition.

EFAMA has reflected on the proposed anti-tax avoidance rules in the six specific fields (deductibility of interest, exit taxation, a switch-over clause, a general anti-abuse rule (GAAR), controlled foreign company (CFC) rules and a framework to tackle hybrid mismatches). Especially with respect to the deductibility of interest, the switch-over clause, the general anti-abuse rule (GAAR), the controlled foreign company legislation and the framework to tackle hybrid mismatches some concerns arose which we would like to comment below.

1. The deductibility of interest

EFAMA welcomes the proposed exemption for financial undertakings such as funds (UCITS and AIFs), given their special features, to the deductibility of interest rule according to which the amount of interest that the taxpayer is entitled to deduct in a tax-year should be limited. We are however concerned that the definition of 'financial undertaking' does not include fund subsidiaries to AIFs, such as say a local property holding company that would routinely be used.

We also understand that consideration is being given to allowing the 'financial undertakings;' exemption to be a member state option. EFAMA is of the opinion that the proposed rule has to be implemented consistently among all member states. The legal uncertainty and the consequent impact on the flow of finance through funds will get worse in case too much flexibility regarding the implementation is given to the member states.

EFAMA would strongly recommend to maintain the EC's proposed wording *"Paragraphs 2 to 5 shall not apply to financial undertakings",* and for this reason we would not support to replace this wording by "*Member states may exclude financial undertakings from the scope*".

EFAMA believes the long term goal should be clear and consistent safe harbour rules for the fund industry.

Lastly, we are disappointed to note the absence of any public financing exception in the draft proposal, when both the OECD Action 4 work and UK legislative proposals on interest deduction limitation include this. The asset management industry can and does finance infrastructure projects that are of public benefit. We do not discern the public policy goal in failing to encourage more such investment.

2. Switch over clause

As drafted, the Switch Over clause appears to suggest that an ordinary investor in a UCITS or AIF would mandatorily be charged tax on distributions from that fund – to the extent the portfolio includes assets in non-treaty countries – even where such distributions would normally be exempt in that investor's hands. This would for example be a problem with a fund tracking the standard MSCI Emerging Markets index. This we would hope is entirely unintentional and would cause significant disruption to the UCITS as well as AIF sector. We suggest that the easiest way to address this is to specify that the "entity" referred to in draft Article 6 does not include a 'financial undertaking' (as defined).

3. General anti-abuse rule (GAAR)

EFAMA believes that the proposed GAAR rule according to which non-genuine arrangements should be ignored for the purpose of calculating corporate tax liability leaves much room for national interpretation at member state level and therefore has the risk of creating damaging legal uncertainty.

The directive proposes that arrangements shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons. EFAMA is concerned that this wording leaves too much room for subjectivity, and therefore does not provide clarity as to how tax national authorities will decide whether an arrangement has been set up for commercial purpose or not.

CIVs are widely held and also distributed to small investors with the aim of retirement saving and not tax avoidance. Especially UCITS cannot have leverage or subsidiaries. EFAMA would therefore recommend that the draft Directive clarifies that CIVs as well as non-CIVs with similar characteristics (which means widely held, no leverage and no subsidiaries) are not to be considered as creating opportunities for tax abuse and therefore are explicitly excluded from the scope of the GAAR rule.

4. Controlled foreign company legislation

EFAMA welcomes the proposed exemption for financial undertakings such as funds (UCITS and AIFs) given their special features. We would therefore strongly recommend to maintain this exemption.

5. Framework to tackle hybrid mismatches

This ATA rule differs a lot from the OECD proposal, both with respect to the identification of hybrid mismatches as well as with respect to the framework to tackle those issues. The Action 2 recommendation does not refer to the characterization of instruments or entities. In case of a deduction of the income on one side without a corresponding inclusion on the other side / a double deduction the source jurisdiction should deny the deduction. In contrast the ATA draft directive recommends that the state where the payment is received should subject the payment to tax. EFAMA

believes that this situation could trigger legal uncertainties and confusion as the ATA rule will only be applicable to hybrid mismatch situations among member states (not affecting any third country). Should third countries be affected, other rules could be applicable, hence increasing the legal uncertainty.

Moreover, the ATA rule does not refer to special capital market transactions like repos or stock lending issues. It seems therefore important that the proposal clarifies that stock lending is carved out by the rules and that member states cannot implement this rule with retroactive effect. Investment funds need to have the certainty that the taxation treatment at the time of making the investment can be achieved.

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