Fill the glass to the brim

Analysis of the tax implications of UCITS IV and the impact for funds operating cross-border

KPMG INTERNATIONAL

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Contents

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Introduction

As part of its drive to create a single European market for investors, the European Union has produced a series of directives, collectively called the Undertakings for Collective Investments in Transferable Securities (UCITS), which together seek to develop a pan-European regulatory framework governing the sale of a collective investments product. The intention is that local laws should be amended to bring them in line with the various UCITS provisions, creating a harmonized market within the EU.

UCITS IV is the latest of these directives. It has the same mechanism for application as its predecessors, but in addition to the legal, administrative and commercial challenges posed by previous UCITS measures, it also carries significant tax considerations. Prior to UCITS IV the operational models were largely kept within national boundaries. UCITS IV innovates in providing new opportunities to operate cross-border Fund platforms.

However the "Schengen treaty" concept does not exist in EU tax matters. Every time services cross borders, tax issues might arise. Is tax jeopardizing the success of UCITS IV's vision?

In cooperation with the European Fund and Asset Management Association (EFAMA), KPMG member firms across Europe have been studying UCITS IV to establish whether it works across different tax jurisdictions without adversely affecting administrative operations, the fund or the investor. This report is a summary of KPMG's findings.

We hope our report brings light to the subject and wish you good reading.

Georges Bock

Global Chairman
KPMG's Funds Tax Network

"The 'Schengen treaty' concept does not exist in tax matters and governments have to adapt the tax framework before UCITS IV can get fully off the ground. Optimists might see UCITS IV as a glass half full, pessimists as a glass half empty. We want to help fill the glass to the brim in order to eliminate uncertainties from this market."

Glass half **full**, or glass half **empty**?

The need for certainty

UCITS funds are intended to be marketed to retail investors i.e. the general public. At the best of times, it is important that all possible uncertainties are removed from this market, to provide the necessary confidence for people to invest.

This is of great importance in today's difficult economic environment. Retail investors demand and deserve legal certainty and it is up to legislators to provide a sound basis on which good investment decisions can be made.

There is much in the UCITS IV directive that will help achieve this goal. But KPMG has also identified some important tax issues that are outlined in this report and are covered in more detail in the accompanying background information. Those tax issues highlighted should be addressed if UCITS IV is to provide the platform for a truly pan-European product. Our research found numerous examples of discrimination and inequitable application of UCITS IV in varying degrees.

The EU commission and certain Member States should consider addressing the points highlighted in this report so as the directive's objectives are met.

Our recommendations include:

- In the case of Fund Mergers: a separate EU directive, based on the ideas reflected in the EU Merger Directive covering taxation issues for cross-border fund operations both at the level of the fund and of the investor.

- For the Management Company Passport: define new EU-wide rules for the taxation of funds and their management companies on a cross-border basis. Or, alternatively, to avoid these new complexities and to keep the status quo, national tax rules should exempt UCITS undertakings from the "Effective Seat of Management" doctrine. In doing so, the funds could remain taxable in the country of establishment, even if they are being managed by a non-resident EU-based management company.

- For VAT: a more uniform approach should be taken by Member States for the application of a "taxable person" for when they consider a fund to be a "taxable person" for VAT purposes. Moreover a more uniform interpretation of what activities constitute VAT exempt fund management should be recommended to distortions within the European Union. These goals would be amongst others achieved within the current negotiations on the amendment of the European VAT Directive governing financial services.

Optimists might see UCITS IV as a glass half full, pessimists as a glass half empty. This report is intended to help fill the glass to the brim, as there is no room for uncertainty in this key market.

UCITS IV

Key tax issues

Our findings are focused on the main tax constraints associated with UCITS IV on the three crucial areas of harmonization offered by the directive in relation to cross-border fund structuring.

These are:

- The cross-border merger of two or more EU-domiciled funds;
- The management company passport and cross-border management of fund structures and;
- The establishment of cross-border Master-Feeder structures.

In order to highlight our findings we have used a traffic light system.

- A green light signifies business as usual. No specific action by an industry participant is required as a consequence of UCITS IV, as per the chosen scenarios. That is to say that the issues raised are not specifically related to the directive and are normal considerations that a business decision would be based on.
- An amber light means that the situation should be monitored closely by industry participants as to possible adverse tax consequences of any one of the scenarios.
- A red light is interpreted as an area in which amendments to local legislation may be necessary before the industry players can be sure that tax neutrality is achievable. It also indicates that material issues should be addressed so that ultimately investors are protected from an unfair tax liability or from discriminatory tax treatment.

The traffic light system focuses on the main countries where EU funds are domiciled and managed. In the case of relocating the Management Company out of the local jurisdiction, we have focused on six main locations of domicile within the EU. The system is useful to view the various issues that arise across the different jurisdictions. There is also a brief country synopsis included to provide explanations on each scenario. Further detailed country analyses can be found in the EFAMA-KPMG UCITS IV tax report.

The aim of this study* is not to give an indication of which is the most favorable UCITS IV location. This will vary on a case-by-case basis. Nor should a red light be interpreted as a "no go" for a country. Its aim is simply to outline certain considerations for the industry before UCITS IV can fully meet its intended objectives. A further aim is to encourage thought on the development and creation of an optimal EU tax framework to allow the fund industry to compete on a worldwide basis.

1. Cross border Merger Scenario (outbound)

Countries	Spain	Germany	France	Luxembourg	Ireland	UK	Italy	Finland	Sweden
Fund level **									
Investor level***									

** To the extent that a fund holds UK equities then UK stamp duty may apply on a merger unless clearance requirements are satisfied
*** Tax resident in the respective country

Source: KPMG International, March 2010

*This study was undertaken from April 2009 until March 2010

2. Management Company Scenario

Countries	Spain	Germany	France	Luxembourg	Ireland	UK	Italy	Finland	Sweden
ManCo level[1]							X	X	X
Fund level									
Investor level*									

* Tax resident in the respective country

3.1. Master-Feeder Scenario: Transformation of Fund into a Feeder[2]

Countries	Spain	Germany	France	Luxembourg	Ireland	UK	Italy	Finland	Sweden
Fund level						**			
Investor level									

** Under new proposed tax legislation Stamp Duty Reserve Tax should not apply to a UK feeder fund that invests in a foreign master where the underlying investments are foreign equities/brands

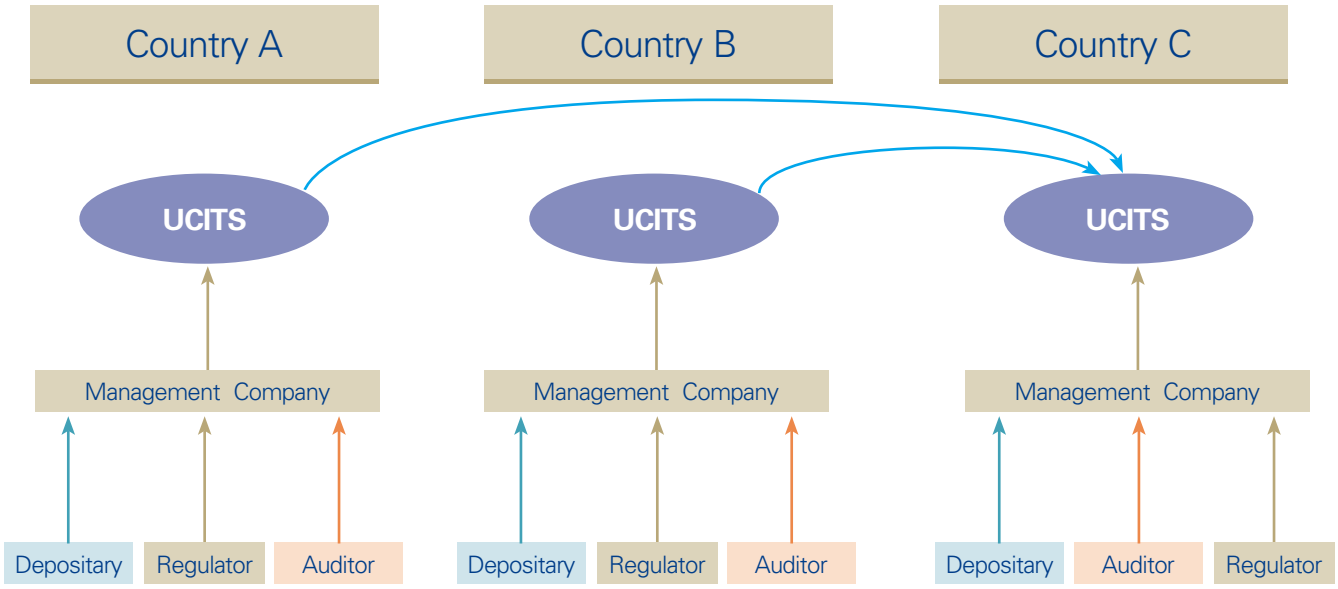
3.2. Master-Feeder Scenario: Ongoing taxation between Master and Feeder[3]

Countries	Spain	Germany	France	Luxembourg	Ireland	UK	Italy	Finland	Sweden
Fund level: WHT on dividends									
Fund level: redemption of units	[4]			[5]					

1 Outbound without keeping a branch
2 Transformation of a local fund into a local Feeder of a foreign Master
3 Transformation of a local fund into a Master having a foreign Feeder
4 Uncertainty on application of exemption exists in case of non treaty FCP holding participations in Spanish master for 25% or more.
5 Taxation of capital gain if non - resident feeder fund has participation of at least 10% in Luxembourg incorporated master fund and capital gain realized less than 6 months after acquisition

Source: KPMG International, March 2010

The cross-border merger of **two** or **more** EU-resident funds



Source: KPMG International, March 2010

KPMG's analysis recommends that a separate EU directive, based on the ideas reflected in the EU merger directive covering taxation issues for domestic, foreign and cross-border fund reorganizations (Table 1), is necessary to ensure and promote the further development of the EU fund market.

Different tax treatment

UCITS IV will oblige all EU-countries to allow cross-border mergers from a legal and regulatory point of view. The tax treatment of fund mergers varies from country to country. While some countries allow tax neutrality for domestic mergers, most, will tax foreign and cross-border fund reorganizations either at the level of the fund (Table 2) or/and at the level of the investor (Table 3).

Table 1: Possible merger situations

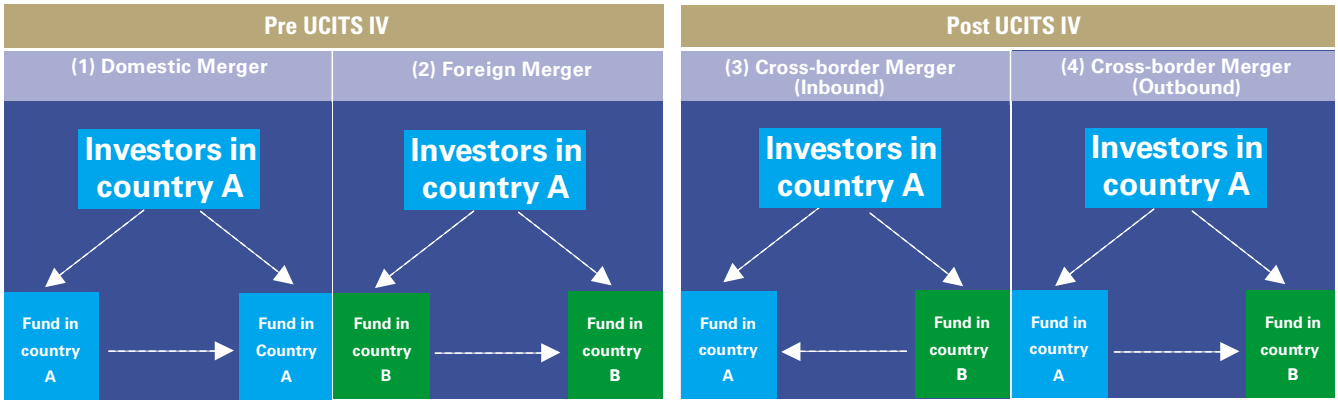


Table 2: Does taxation arise at Fund level in the following cases?

Country	Domestic Merger	Cross-border Merger (Inbound)	Cross-border Merger (Outbound)	Discriminatory	Tax Neutrality
Finland	NO	YES	YES	👎	×
France	NO	NO	NO	👍	✓
Germany	NO	NO	NO	👍	✓
Ireland	NO	NO	NO	👍	✓
Italy	NO	YES	YES	👎	×
Luxembourg	NO	NO	NO	👍	✓
Spain	NO	NO	NO	👍	✓
Sweden	NO	YES	YES	👎	×
UK	NO	NO	NO	👍	✓

👍 = No discrimination 👎 = Discrimination ✓ = Generates no taxation × = Generates taxation

Source: KPMG International, March 2010

Table 3: Does taxation arise at investor level in the following cases?

Country	Domestic Merger	Foreign Merger	Cross-border Merger (Inbound)	Cross-border Merger (Outbound)	Discriminatory	Tax Neutrality
Austria	YES	YES	YES	YES	👍	×
Belgium	YES	YES	YES	YES	👍	×
Cyprus	NO	NO	NO	NO	👍	✓
Czech Republic	NO	YES	YES	YES	👎	×
Denmark	YES	YES	YES	YES	👍	×
Estonia	NO	NO	NO	NO	👍	✓
Finland	NO	YES	YES	YES	👎	×
France	NO	YES	YES	NO	👎	×
Germany	NO	NO	YES	YES	👎	×
Greece	NO	NO	YES	YES	👎	×
Hungary	YES	YES	YES	YES	👍	×
Ireland	NO	NO	YES	YES	👎	×
Italy	NO	YES	YES	YES	👎	×
Luxembourg	YES	YES	YES	YES	👍	×
Malta	YES	YES	YES	YES	👍	×
the Netherlands	YES	YES	NO	YES	👎	×
Poland	YES	YES	YES	YES	👍	×
Portugal	YES	YES	YES	YES	👍	×
Romania	YES	YES	YES	YES	👍	×
Slovakia	YES	YES	YES	YES	👍	×
Spain	NO	YES	YES	YES	👎	×
Sweden	NO	NO	YES	YES	👎	×
UK	NO	NO	NO	NO	👍	✓

👍 = No discrimination 👎 = Discrimination ✓ = Generates no taxation × = Generates taxation

Source: KPMG International, March 2010

For funds' reorganizations there are still cases where tax discrimination arises based on the fund's residency. In Finland, for example, a domestic fund merger does not trigger tax on a reorganization, while a foreign or cross-border merger of funds creates a taxable event in the hands of a Finnish resident investor.

The situation becomes more complex when one considers the different legal forms of UCITS in different EU countries. The present directive distinguishes between three types of funds: a contractual fund, a corporate fund and a unit trust.

Not all of these legal structures are available in all member states (**Appendix 1**), and in some countries no taxable event arises when fund reorganizations are limited to domestic and foreign funds that have the same legal form; for example, the merger of one corporate fund with another corporate fund. In countries where domestic law does not recognize the contractual form, a foreign or a cross-border contractual fund reorganization would create a taxable event. This can be seen as a form of discrimination, based on the legal form of the funds.

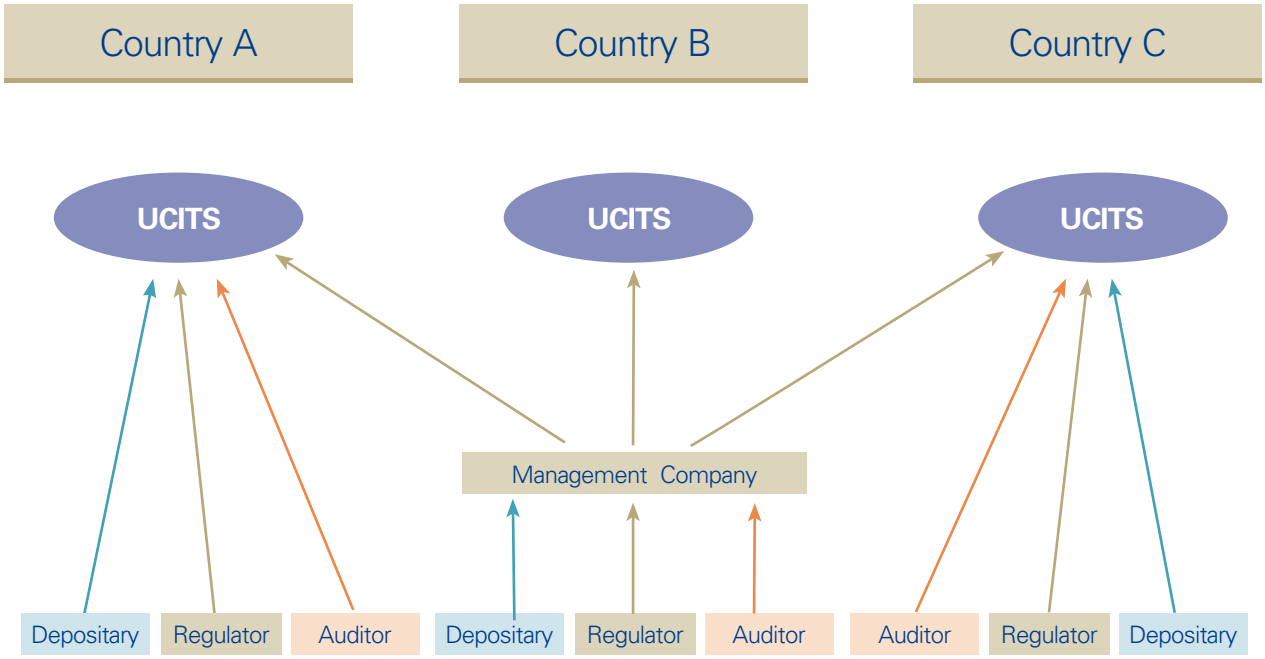
Non-comparable legal structures

One of the main issues in a cross-border merger is the complexity arising from non-comparable legal fund structures. While it is generally possible to merge two "comparable" or "well-known" fund structures (e.g. a Belgian and a Dutch Societé d'investissement en capital variable "SICAV") the situation becomes more complex with less common structures, when the legal features of one fund in one jurisdiction are largely unknown in the other jurisdiction.

Currently, most tax laws differentiate between domestic and foreign mergers and are silent when it comes to reorganizations on a cross-border basis. This implies that the extension of tax neutrality to cross-border mergers does simply not apply or is fully at the discretion of local tax authorities, and due to lack of clarity on the terms on which a merger might be exempt, it becomes taxable.

This situation clearly leaves promoters dealing with significant uncertainty. It poses a serious obstacle to the realization of an efficient single market for funds within the EU, which is the bedrock of the UCITS IV directive's objectives. Therefore, it is of great importance that the movement towards a single European fund market is further supported by a set of common rules on the taxation of cross-border fund operations.

Management Company Passport



Source: KPMG International, March 2010

Historically, UCITS funds were legally obliged to be managed by management companies located in the jurisdiction of the establishment of the fund. This leads to an alignment of the management of the fund, carried out by the management company, and the supervision of the fund, carried out by the local supervisory authority or regulator.

Under UCITS IV it will become legally possible for a fund to be managed by a management company located in a different EU jurisdiction to that of the establishment of the fund. For this to happen it might be necessary to either merge multiple management companies into one single management company, or to relocate the management company from the fund's jurisdiction to another domicile.

Single management company

To achieve a single management company, no particular taxation issues should arise, as management companies are generally set up as EU-resident corporations. The EU Merger Directive rules, as transposed into national law, should apply and could render most of these operations largely tax neutral.

If the Merger Directive applies to the transfer of a management company's business, it may lead to an exit tax obligation. But in any case, UCITS IV implementation at the level of the management company appears to be clear and no major unknown or unexpected tax consequences should arise.

Cross-border management

More complex taxation issues arise at the fund level in the case of cross-border management companies. These focus on the question whether the relocation of the management company of a fund from one EU jurisdiction to another entails a change in tax jurisdiction at the level of the fund. More specifically, as many EU countries define tax residency as the location where the business is effectively managed. The question arises as to whether the country of establishment of the fund or the place of establishment of the management company defines the residence of that fund.

There should be no major problems in the case of corporate funds, as they have a place of residence and are generally listed in the companies' register of the local jurisdiction. As long as their corporate governance and their management and control is exercised at their place of establishment, the transfer of the management company to a third country should not lead to a change of residency of the fund.

If the fund has a contractual form or is established as a unit trust, then the situation is rather different. In these cases, many EU member states, including the UK, Germany or Spain, will deem tax residency to correspond with that of the management company of the fund. Consequently, a transfer of the residency of the management company leads to a transfer of the tax residency of the fund.

This gives rise to a broad range of taxation issues. For example:

- Since no taxation rules presently exist for the relocation of a contractual fund or a unit trust from one EU jurisdiction to another, some jurisdictions like Italy could consider the transfer to be a liquidation of the fund in their country. This may lead to taxation of unrealized capital gains.
- The jurisdictional separation of the management company and the fund could lead to double taxation or double tax exemptions at fund level. For example, a Spanish contractual fund, having a management company in Luxembourg, would probably not be subject to taxation in Spain. At the same time, the fund might not be subject to any taxation in Luxembourg. But if a Luxembourg fund is managed by a Spanish management company, both a subscription tax in Luxembourg and a 1 percent Spanish tax on the fund income would be due.
- The relocation of the management company to a jurisdiction other than that of the fund could also entail taxation of the fund income in the jurisdiction of the management company at current full rates. Exemptions, partial exemptions, or special low tax regimes are often restricted to domestic funds only and are not available to foreign funds. For example, in Germany, foreign contractual funds managed by a German management company will be taxed at a rate of 15.825 percent.
- The separation of the management company and the fund could lead to withholding taxes on distributions from the fund to its investor in its country of establishment and/or in the jurisdiction of the management company. An Irish or French contractual fund managed by a Spanish management company might be required to pay Spanish withholding tax on its distributions.
- Finally, the jurisdictional separation of the management company and the fund could alter the ability of the fund to access Double Taxation Treaties. On one hand, for example, France will deny the application of its Double Taxation Treaty network to a foreign fund managed by a French management company. On the other hand, Spain may give access to its treaty network to foreign funds managed by a Spanish management company.

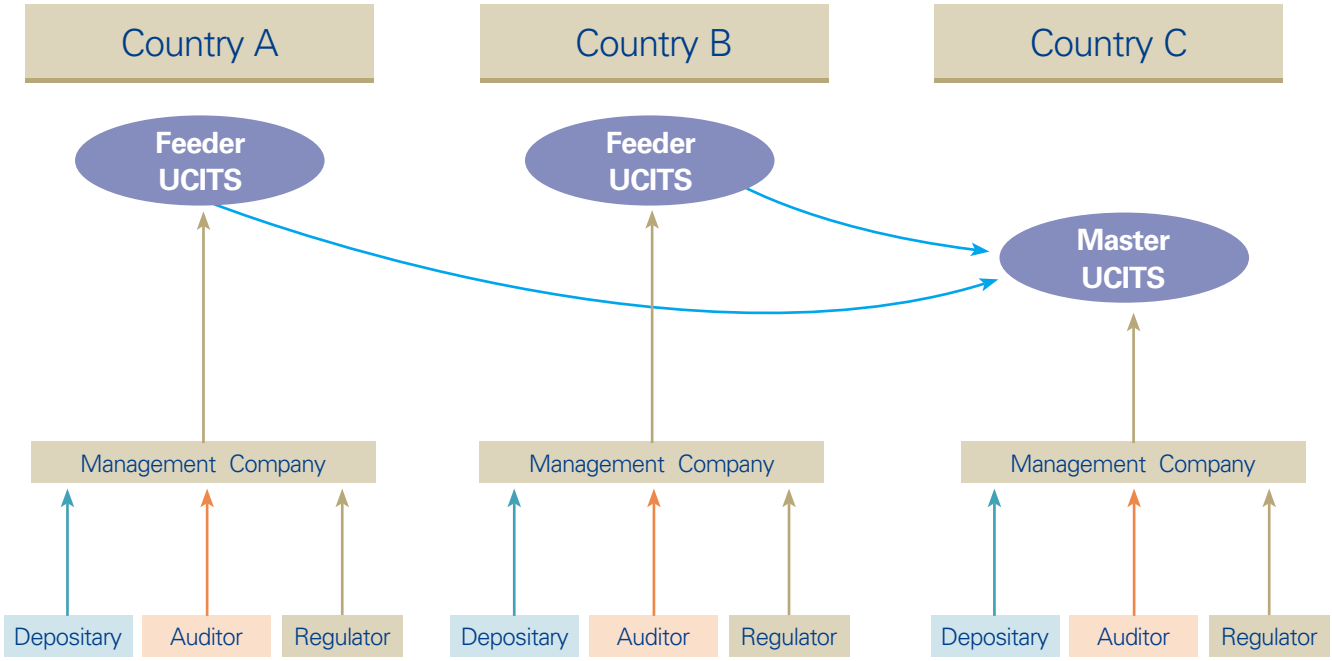
A pragmatic approach might consist of having a single management company that operates a branch in each fund location with enough substance to supervise the effective seat of management in the country of establishment of the fund. However, this would clearly be contrary to the objectives of UCITS IV.

New tax rules urgently needed

It is clear that many unresolved taxation issues arise under the management company passport provisions of the new UCITS IV Directive. In our view, it is therefore of paramount importance to define new rules within the EU to determine the tax residences of funds and their management companies on a cross-border basis.

An alternative approach, to avoid these new complexities and to keep the status quo, would be for national tax rules to exempt UCITS undertakings from the "Effective Seat of Management" doctrine. In doing so, the funds could remain taxable in the country of supervision, even if they are being managed by a non-resident EU-based management company.

Master-Feeder structures



Source: KPMG International, March 2010

One of the objectives of UCITS IV is to create an environment that allows for the pooling of assets into a master fund. The aim is to lower costs by developing economies of scale. The proposal allows for several feeder funds to invest in a single master fund, provided each of these feeders invest more than 85 percent of their assets in the master.

Setting up a master-feeder structure with a local management company generally does not bear negative tax consequences. However, the same cannot be said on a cross-border basis.

Critical location issues

The possibilities provided for under UCITS IV are extensive. It appears, however, that the pooling of assets in a master fund in order to streamline operations and gain economies of scale may be a critical point in the ultimate decision on the final location of the single management company. Introducing the master-feeder concept into the UCITS world therefore ideally implies transforming existing domestic UCITS into local feeder funds and transferring these assets into a newly created or existing master fund, located in the country of choice.

Restructuring of this kind inevitably raises tax considerations. They are not limited to taxation at fund level, but also appear at investor level and at the level of the management company. The main considerations are:

Taxation at fund level: Are investment funds really paying no tax?

Investment funds are generally not taxed. This is also the case with domestic master-feeder relationships. Hence when the master distributes to the feeder no withholding tax is due.

But in a cross-border relationship, the situation might be different, as some local tax provisions have yet to integrate the concept of cross-border master-feeders. Countries like Ireland or Luxembourg will not withhold taxes on a distribution of this kind; France or Spain might. The feeder funds could reclaim the withheld tax on the basis of the recent Aberdeen European Court of Justice (ECJ) case, but the administrative burden and cash deferral disadvantage would still remain.

Another way of repatriating cash from the master to the feeder is by redeeming units of the master. Some countries, such as Luxembourg, still have specific capital gains tax provisions on the sale of substantial holdings in domestic companies by non-resident taxpayers. These rules are typically overridden by Double Tax Treaties. However, concrete examples like France deny the application of its Double Tax Treaty network to funds.

Countries taxing their investment funds at a much-reduced rate (like Spain) may go a step further and claim treaty protection for their investment funds. Already today, the ECJ decision in the Aberdeen case (C - 303/07) reduces withholding tax levies in the case of dividend distributions from local companies to local investment funds which are not subject to withholding tax whereas cross-border distributions suffer withholding tax.

Table 4: In case of a Master-Feeder structure, is there any withholding tax upon profit distribution?

Country	Tax neutrality
Finland	×
France	×
Germany	×
Ireland	✓
Italy	✓
Luxembourg	✓
Spain	×
Sweden	×
UK	✓

✓ = No withholding tax × = Withholding tax

Source: KPMG International, March 2010

Table 5: Is the levy of a Withholding tax discriminatory?

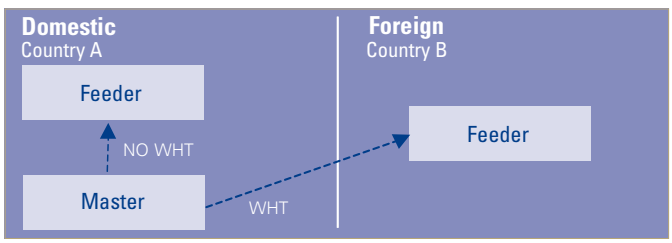
Country	Distribution From a Company to a Master Fund [1]	Distribution from a Master Fund to a Feeder Fund
Finland	👎	👎
France	👎	👎
Germany[2]	👎 2	👍
Ireland	👍	👍
Italy	👎	👍
Luxembourg	👍	👍
Spain[2]	👎 2	👎 2
Sweden	👎	👎
UK	👍	👍

👍 = No discrimination 👎 = Discrimination

Source: KPMG International, March 2010

Discriminations:

- Two comparable situations are treated differently.
- Profit distribution to domestic and foreign funds should be treated the same.
- If a WHT is levied in a cross-border situation, whereas a pure domestic distribution is WHT exempt, such situation would be considered as discriminatory.



Source: KPMG International, March 2010

1 Based on ECJ decision in the Aberdeen case (C - 303/07)

2 In a cross-border situation, the WHT is not refundable

The investors' corner: "Master-feeder? Fine as long as it does not trigger additional tax!"

In today's world the transformation of existing UCITS into feeder funds will be done at market value. In other words, gains not yet crystallized at the level of the investor could become taxable for example in countries like Germany.

Roll-over provisions sometimes exist when restructuring funds under national law, but not always if the assets are transferred to a master fund domiciled in another Member State. A French investor could benefit from roll-over provisions in a domestic transformation, while the French Tax Authorities might deny roll-over provisions in a cross-border transfer of assets.

The Single Management Company: How to get the fee policy right?

While a new set up of a Master-Feeder structure would be managed under the single Management company passport concept, the situation could be different in case of transformation of an existing Fund into a Feeder.

In the latter case, it would seem unlikely to expect a single management company to manage the master fund in conjunction to the feeder funds. We anticipate rather that the functions and duties of managing these funds are going to be split between the management company competent for the master fund and the various managing companies assuming the responsibility for the feeder funds.

UCITS IV foresees that the relationship between the feeder and master management company will need to be based on contractual arrangements. This process should give the fund industry the opportunity to clarify current practice, submit to an intensified transfer pricing review and make proposals as to the impact of the upcoming VAT package for financial services on these arrangements.

Indirect tax

Other matters outside UCITS IV

One of the key issues arising from UCITS IV is the risk that a merger of funds in some instances may result in the transfer of assets being subject to VAT. However, it is expected this risk could typically be mitigated through careful planning of the merger as a VAT-free transfer of a business as a going concern. Alternatively, it is expected that a VAT exemption may apply in the majority of cases where the transfer is within the scope of VAT.

Differences between Member States in how they implement the European VAT directive result in some VAT distortions within the fund management sector. These distortions include:

- Differences in the application of VAT exemption to fund management. There is clearly scope within the current negotiations on the rewrite of the European VAT Directive governing financial services for this distortion to be addressed via an appropriate change in law;
- Differences whether Member States consider a fund to be a "Taxable Person". Where fund management services are provided cross-border this may impact whether the services fall to be taxed in the manager's or fund's Member State. A more uniform approach by Member States to when they consider a fund to be a taxable person would mitigate this distortion; and
- Differences between Member States in their interpretation of what activities constitute fund management.

The increase in volume of cross-border management services which will arise from UCITS IV will result in these VAT distortions obtaining a higher visibility.

Country reports

Finland

France

Germany

Ireland

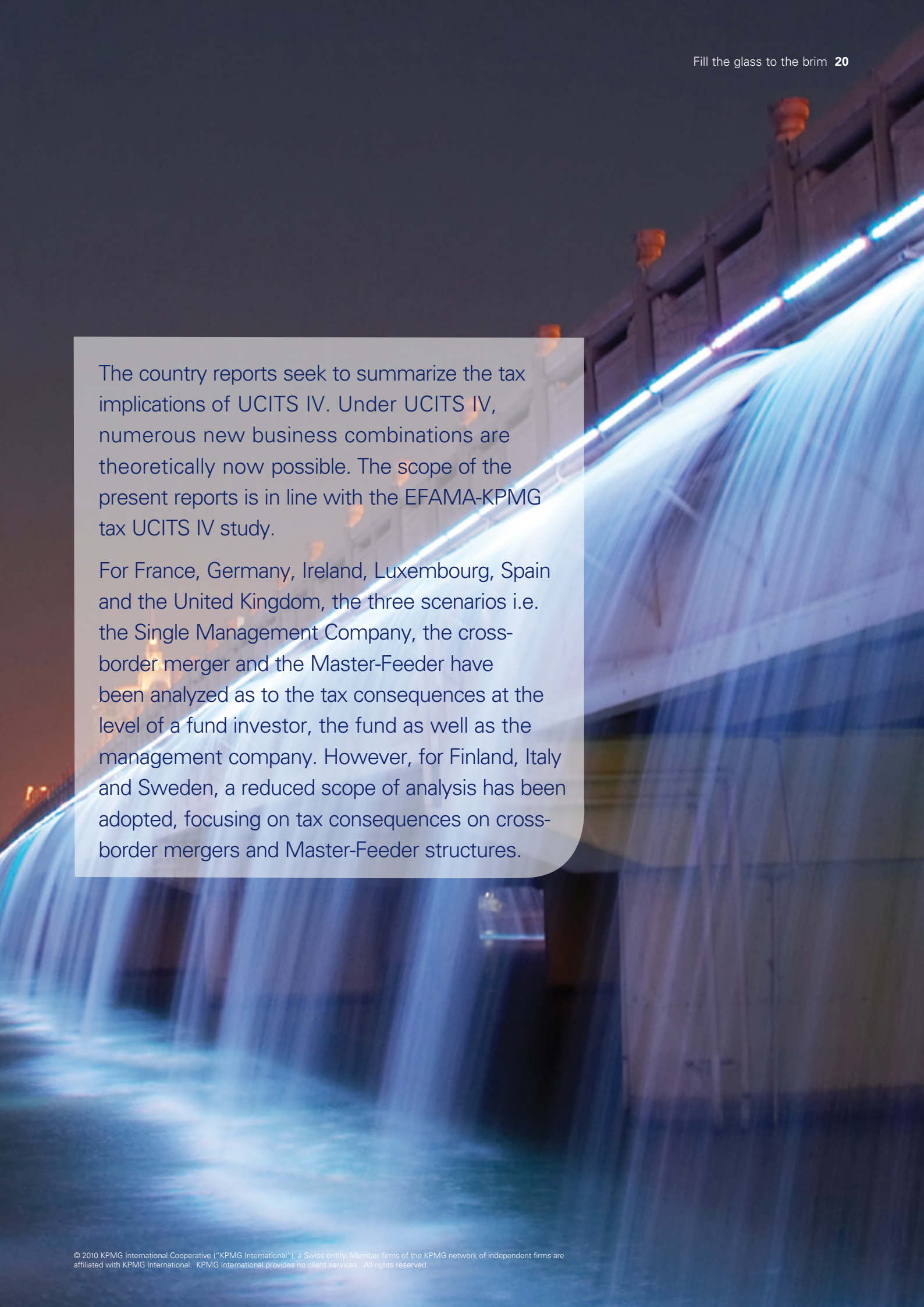
Italy

Luxembourg

Spain

Sweden

United Kingdom



The country reports seek to summarize the tax implications of UCITS IV. Under UCITS IV, numerous new business combinations are theoretically now possible. The scope of the present reports is in line with the EFAMA-KPMG tax UCITS IV study.

For France, Germany, Ireland, Luxembourg, Spain and the United Kingdom, the three scenarios i.e. the Single Management Company, the cross-border merger and the Master-Feeder have been analyzed as to the tax consequences at the level of a fund investor, the fund as well as the management company. However, for Finland, Italy and Sweden, a reduced scope of analysis has been adopted, focusing on tax consequences on cross-border mergers and Master-Feeder structures.

Antti Leppanen

Finland

"The absence of tax framework is a considerable challenge for utilizing the platform which UCITS IV provides for pan European fund products. In Finland, funds are tax exempt but a number of tax issues and uncertainties still remain especially at the level of investors. Even if the selection of the preferred fund structure and business model is primarily based on business considerations, tax issues will undoubtedly have a very important impact. Finnish domestic tax legislation should be amended in order to ensure that UCITS IV may be fully utilized to address the economies of scale, cost savings and improved efficiency in fund industry."

I) Single Management Company

Investor level

The merger of Management Companies (inbound and outbound) as well as the conversion of a Management Company into a branch will not trigger any taxation at investor's level as long as the potential change in tax residency of the UCITS would not imply the disposal of the units.

Fund level

The transfer of a Management Company does not trigger any taxation at fund level. The same conclusion applies to the full or partial transfer of the Management Company's activities.

II) Cross-border Merger

Fund level

Domestic merger: At the level of the fund, a domestic merger should not trigger taxation as the funds are not subject to income tax in Finland.

Cross-border Merger: Legally, Finnish funds cannot currently merge cross-border. As the merger would not be regarded as a merger from legal point of view, Finnish transfer tax would be due on the transfer of Finnish shares. Merger should not trigger corporate income taxation as the funds are not subject to income tax in Finland

Investor level

Domestic merger: The merger of the Funds does not trigger taxation at the investor's level if carried out in accordance with Finnish Business Income Tax Act. These special provisions apply to a merger in which one or more Finnish companies are dissolved without liquidation and all of the assets and liabilities of the dissolved company are transferred to another Finnish company. The dissolved company's shareholders, who may be residents or non-residents, must receive shares in the receiving company as compensation in proportion to their

shareholding. A small part of the compensation, corresponding to no more than 10 percent of the nominal value of the shares received as compensation, may consist of a cash payment. The cash payment is taxable for the Finnish resident unit holders.

Cross-border merger: Cross-border fund merger has not yet been tested in Finnish tax law, and so Finnish funds cannot currently merge cross-border. Currently, there is no tax legislation which would guarantee that cross-border merger could be carried out tax neutrally from the Finnish investor point of view. According to the Finnish Courts a merger of two SICAVs can be carried out tax neutrally from Finnish investor point of view. Thus, it could be expected that corporate and unit trust mergers could be tax neutral at the investor level if carried out in a way that corresponds with the merger described in Finnish Business Income Tax Act, but this is uncertain. It is even more uncertain whether a merger of contractual funds can be tax neutral from a Finnish investor's point of view.

III) Master – Feeder

Fund level

In case the master fund is located in Finland and the feeder fund is located abroad, there would be a withholding tax when distributions are made from a domestic (Finnish) master fund to a foreign feeder fund. If the foreign feeder is eligible to tax treaty benefits, the tax treaty may prevent this. Also, no withholding tax is levied in case the domestic master fund redeems its units. However, withholding tax might be levied when the master fund makes distributions (distribute profits).

Investor level

Both in a domestic and in a cross-border situation, the conversion of a Fund into a Master or Feeder Fund should not trigger taxation at the level of the investor if the investor keeps the original units.

Yves Robert

France

"Tax aspects are not addressed by UCITS IV but will play a crucial role at the time of any restructuring and on the on-going taxation as well. Whatever the location of the Management Company and of a fund resulting from a merger or transformed into a feeder fund, accounting principles and declaration obligations shall be met to permit the investors resident in another state to benefit from their relevant tax regime. The full tax exemption of French funds may ensure more tax neutrality in the framework of a European collective investment market."

I) Single Management Company

Management Company level

Under UCITS IV it will be possible to transfer an existing Management Company from/to France. However, the transfer of an existing Management Company outside France could give rise to taxation unless the assets and liabilities remain assigned to a French permanent establishment (under certain conditions). The transfer of an existing Management Company into France would not trigger any taxation in France but any income and gains on business activities carried out in France, will be subject to French CIT at the standard rate (34.43%) as from the transfer.

As a result, the transfer of activities could lead to taxation in the case of a partial or full transfer of functions outside France. However, should all the assets and liabilities (and consequently the functions) remain assigned to a French branch then this is a tax neutral event. The transfer of a management company to France should not constitute a taxable event in France. Any result of the French Management Company will be taxable in France as from the transfer.

Fund level

Outbound: The transfer of a French management company abroad should not raise any tax residence questions in France since funds are not considered as having a tax residency, from a French tax standpoint.

Inbound: The change of the domicile of a non French contractual fund to France would be tax neutral (from a French tax viewpoint) as long as funds domiciled in France continue not to be liable to tax in France.

Investor level – Change in location of the fund

There is no requirement to disclose unrealized gains at investor's level as long as the potential change in the tax location of the management company of the UCITS fund would not imply a disposal of the shares/units.

Investor level – Ongoing taxation

Dividend distributions from a French domiciled fund to a foreign investor will be subject to a 25 percent withholding tax (WHT) or reduced treaty rate if applicable. In the case where the income paid by the French domiciled fund came from abroad and as such was subject to a foreign WHT, the French tax regulations allow for offsetting the tax credit corresponding to the foreign WHT against the French WHT.

The levy of French WHT on dividend distribution to foreign investors could be considered discriminatory since French investors would not suffer French WHT.

II) Merger

Fund level

From a French regulatory point of view, French funds (FCPs or SICAVs) can presently merge with other French funds (FCPs or SICAVs). In principle, no French tax issues should arise from such a merger insofar as funds are not liable for taxation in France.

Investor level

In respect to the investor, the neutrality would depend on whether or not the merger is carried out under a transaction covered by the French tax neutrality regime or not, with the following particularities:

Domestic Merger: Merger of funds are in principle tax neutral for the investor, provided certain conditions are met (e.g. notably, as regards the level of the cash payment).

Cross-border Merger: According to the French Tax Authorities, the benefit of the deferred taxation regime is subject to the merger being carried out between entities having the same characteristics as the French funds. In the present state of the French tax regulations, certain restructuring transactions involving contractual funds could not benefit from the deferred taxation regime. This could be considered discriminatory as a merger of French domiciled funds is generally tax neutral for the investor.

III) Master – Feeder

Fund level

Master-feeder funds are also not liable for taxation in France.

Investor level

The conversion of a French fund into a feeder fund may benefit from the deferred taxation regime provided that the feeder fund is wholly invested in units or shares of the master fund and ancillary cash.

The tax consequences of the conversion of a fund into a master fund have not as of today been commented on by the French Tax Authorities. Therefore there is some uncertainty in this regard.

Ongoing Taxation – Withholding Tax

Dividend distributions from the French Master Fund to a Feeder Fund located in another Member State will be subject to 25 percent withholding tax or reduced treaty rate if applicable. In the case where the income paid by the French master fund came from abroad and as such was subject to a foreign WHT, the French tax regulations allow for offsetting the tax credit corresponding to the foreign WHT against the French WHT. The application of the French withholding tax could be considered as discriminatory since French domiciled Funds are not liable to taxation.

Andreas Patzner

Germany

"Forced by the German investment associations, there is more and more awareness for the necessity to support the upcoming regulatory framework of UCITS IV by establishing new investment taxation rules. Regarding the single management company, the German association of foreign banks has asked the Federal Ministry of Finance to exempt foreign investment funds with effective management in Germany from German taxation in order to avoid discrimination compared to German funds. Regarding the merger of investment funds, there is already a framework for tax neutrality of investors in German and foreign funds. However, cross-border mergers as well as Master-Feeder transformations have still to be fixed.

I) Single Management Company

Management Company level

Under UCITS IV it will be possible to transfer an existing management company to/from Germany. However, the transfer of an existing management company out of Germany could give rise to taxation unless the assets and liabilities remain assigned to a German permanent establishment.

Fund level

Outbound: A German fund managed by a foreign management company remains tax resident in Germany due to its place of establishment in Germany. The fund remains tax exempt in Germany and bears no additional tax consequences from a German tax point of view, but can encounter foreign tax risks.

Inbound: A foreign fund managed by a German management company can become tax resident in Germany due to its place of effective management. As the German tax law does not exempt foreign funds from taxation, the fund will suffer German corporate income tax (plus solidarity surcharge) at a rate of 15,825 percent.

Investor level

There are no immediate tax consequences for the investor in case of a cross border management. However, any additional tax burden crystallized at the fund level would be passed on to the investor (as cost).

II) Merger

Fund level

There is no impact at the fund level as funds are tax exempt in Germany.

Investor level

The German law allows for tax free mergers only between funds located in the same jurisdiction. Consequently, all cross-border mergers are currently considered as a taxable exchange of fund units.

III) Master – Feeder

Fund level

WHT: A German (master) fund has to withhold tax on payments to a foreign (feeder) fund deriving from German dividends.

Fund level

The redemption of fund units held by another fund does not affect the taxation at the fund level as funds are tax exempt in Germany.

Investor level

The transformation of a fund into a *master* would imply that the investor redeems all the units held in the original fund and receives new units in a feeder; this would be regarded as a taxable exchange of fund units.

Investor level

The transformation of a fund into a *feeder* would imply transferring the fund's assets to the master and consequently a realization of capital gains at the level of the transferring fund; some of these capital gains would then be passed on to the investor at distribution/deemed distribution – leading to taxation.

Investor level

In the current situation, acquiring units of foreign feeder funds which comply with the German provisions on indirect risk diversification is tax neutral for German investors, as they would be treated as regular investors in foreign funds.

Seamus Hand

Ireland

The investment fund industry in Ireland has welcomed the introduction of UCITS IV. The continued expansion and success of the investment fund industry in Ireland following the introduction of UCITS IV and related developments is fully supported by local industry and government. The Irish Government has already introduced tax amendments to remove barriers to taking advantage of UCITS IV in Ireland. As a result, investment funds established in Ireland are well placed to access benefits made available on introduction of UCITS IV and furthermore the general tax environment makes Ireland an attractive location for investment managers providing cross border management services within Europe.

I) Single Management Company

Management Company level

The transfer of all or part of the business of a management company out of Ireland could have tax implications as it could be subject to capital gains tax and/or stamp duty depending on how it is implemented.

Capital gains tax would apply based on the market value of any capital assets transferred (e.g. goodwill). Where the management company retains a branch in Ireland, reorganization relief may apply to avoid any capital gains tax charge. Alternatively, the transfer could be affected by means of a migration of tax residence which in certain circumstances is not subject to capital gains tax.

From a stamp duty perspective, an exemption for transfers between associated companies may be available.

The transfer of all or part of the activities of a foreign management company into Ireland should not attract any Irish taxation on set up. The future profits of such company would typically be regarded as trading for Irish tax purposes and would be subject to tax at the 12.5 percent tax rate.

Where the management company retains a foreign branch, the profits of such branches would be taxable in Ireland but with a credit for foreign tax paid in the branch (typically resulting in no additional Irish tax).

Fund level

A non-Irish fund which is managed by a management company in Ireland would typically not be brought into the charge to Irish tax. There is a specific exemption (investment manager exemption) confirming that the activities of a regulated management company in Ireland would not create a permanent establishment for an unconnected non-Irish fund. The only exception in this regard is where the fund is a trading fund and the activities of the manager constitute a trade being carried on in Ireland which is not likely to be applicable to UCITS.

Investor level

The transfer of the management company would not typically have any tax implications for investors unless it resulted in a transfer of residence of an Irish fund outside of Ireland. Even in such a situation, there should be no significant Irish tax implications for the investors – Irish investors would remain subject to an exit tax albeit that it would be administered under self assessment if the fund moved offshore.

II) Cross Border Merger

Fund Level

There would normally be no Irish tax issues for the fund on a merger as the transfer of assets would be treated as a disposal for tax purposes but is not subject to Irish tax at the fund level under the gross roll-up rules.

To the extent there are any Irish equities in the portfolio, there could be Irish stamp duty implications at a rate of 1 percent. There are certain reliefs which may be available depending on the circumstances.

Investor Level

The disposal of shares in the fund by an investor as part of a merger (on liquidation) could be subject to tax for Irish investors (non-Irish residents are exempt where declarations of non Irish tax residence are provided). Reorganization relief is not available for a transfer of UCITS out of Ireland.

The transfer of UCITS into Ireland as a part of a merger could have tax implications for the investors. However reorganization relief is available to address this issue for a transfer of UCITS into Ireland.

The ongoing tax treatment of investors following a transfer of UCITS into Ireland should not be significant as non Irish investors should be entitled to an exemption from exit tax (based on declarations) and Irish investors would continue to be subject to exit tax albeit based on deduction by the fund as opposed to under self assessment for offshore funds.

III) Master – Feeder Structure

Fund level

The Irish taxation regime for UCITS funds is determined based on their regulatory status and is not connected to the investment strategy. This means that the Irish tax treatment for a master fund should be the same as that for a feeder fund where provided for under the UCITS directive. Therefore, under both scenarios, the fund should benefit from exemption under the gross roll up regime.

A foreign feeder fund should not typically be subject to Irish exit tax in respect of an investment in an Irish master fund (subject to providing a non-resident declaration).

The transfer of assets by an Irish feeder fund to a foreign master should not have any tax implications for an Irish fund as it is exempt from tax.

The acquisition of assets by an Irish master from a foreign feeder should not have any Irish tax implications (unless there are Irish equities).

Investor level

An Irish investor is subject to tax only on an exit event and thus should not be impacted where an Irish fund becomes a feeder as the investors' position is not impacted. The feeder should also not be taxable on distributions from the foreign master as it is essentially exempt from tax.

Sabrina Navarra

Italy

"UCITS IV must be the turning point in harmonizing the tax treatment of mutual funds within Europe; otherwise the aim of the Directive to realize an efficient single market for funds within EU would be thwarted by the adverse tax consequences of the cross-border transactions that would materialize after its implementation. With this in mind, the Italian Government cannot waste this opportunity to overhaul the tax treatment of Italian mutual funds, announced several times over the last few years. Reform is also strongly recommended by asset management industry players in order to eliminate any discrepancy in the tax treatment of foreign and domestic funds being penalized by the application of a 12.5 percent substitute tax on the accrued year-end result."

I) Single Management Company

Fund level

There are no specific rules on the tax residency of investment funds in Italian legislation. The Italian rules governing the tax treatment of Italian collective investment funds consider subject to Italian taxes only those which are ruled by Italian law, irrespective of the place of effective management of the fund. Generally Italian mutual funds are subject to a 12.5 per cent substitute tax (27 percent under certain conditions) levied on the net operating result accrued at year-end (including unrealized gains/losses). Therefore, if in the future, an Italian investment fund will be managed by a foreign Management Company, it should remain subject to Italian taxes.

On the other hand, a foreign fund managed by an Italian Management Company should not be subject to the mentioned substitute tax of 12.5/27 percent.

Investor level

As highlighted above, a change in the residence of the Management Company should not affect the tax treatment of the funds. Subsequently, it should not imply any tax adverse consequence for the investors.

II) Merger

Fund Level

Current Italian tax rules do not cover mergers between investment funds (SICAVs and contractual funds). However, according to the tax authorities' interpretations and the guidelines issued by the Italian association of investment management companies, mergers between Italian funds (managed by the same Management Company) are tax neutral for the fund and the investors if and to the extent that (i) the assets and liabilities of the merged fund are transferred to the merging fund without any interruption of the management by the fund manager and (ii) for the investors the merger implies only an exchange of units in the merged fund against units in the merging fund.

There are no guidelines regarding cross-border mergers between investment funds. There is a potential risk of taxation at fund level (this would affect only the portion of unrealized gains accrued in the year of the merger, since the unrealized gains accrued in the previous years have been already taxed).

Investor Level

There are no guidelines regarding cross-border mergers between investment funds. There is a potential risk of taxation of unrealised gains at the level of certain categories of investors (i.e. individuals that carry on business activities and entities subject to corporate income tax).

III) Master – Feeder Structure

Fund level

The Italian taxation regime for UCITS funds is determined based on their regulatory status and is not connected to the investment strategy. This means that the Italian tax treatment for a master fund should be the same as that for a feeder fund. Therefore, under both scenarios, corporate and contractual funds are subject to a 12.5 percent substitute tax (27 percent under certain conditions) which applies on the net result from the management activity accrued at year-end.

However, a tax residency issue may arise, at the level fund, if it is managed by a Management Company resident in another country.

No Italian withholding tax should be levied on income derived from an Italian feeder investing in a EU master UCITS ("if governed by EU Directives"). Such income is included in the overall result of the management activity, subject to a 12.5 percent substitute tax.

No Italian withholding tax should be levied on payments from Italian master funds to EU feeder funds, which are entitled to receive a refund, equal to 15 percent of income distributed by the domestic fund, or realized upon redemption of the units.

Investor level

No taxation should be triggered in Italy at the investor's level to the extent that the investor will keep units/shares of the same Funds.

Claude Poncelet

Luxembourg

"Tax implications are going to play an important role in the success of UCITS IV. The fund industry will need to address them proactively in order to benefit fully from the advantages such as cost savings or enhanced EU market access. Luxembourg's Finance Minister recently announced a change in domestic legislation in order to ensure tax neutrality especially in the master-feeder scenario. By doing so, the Luxembourg legislator supports the continuous development of Luxembourg as a preferred location for UCITS funds. Based on latest EAMA statistics, Luxembourg is the leading country of domicilation for UCITS funds with 30 percent of the net assets of the European UCITS industry."

I) Single Management Company

Management Company level

The transfer of a Management Company abroad should not be subject to exit tax provided that a branch continuing the activity is left in Luxembourg.

A branch may qualify as a permanent establishment (PE) for tax purposes. In principle, the profits of a foreign PE are subject to tax in Luxembourg, with tax credit under domestic law. However, if Luxembourg has concluded a tax treaty with the country in which the PE is located providing for the exemption method, the PE will be taxed in that country. It should be noted that Luxembourg has a double tax treaty with most EU countries.

The transfer (full or partial) of an existing management company (or its activities) of a UCITS from Luxembourg to another Member State (outbound situation) realizes a taxable event by triggering an exit tax on the hidden reserves and unrealized capital gains.

The transactions set out above (i.e. full or partial transfer into Luxembourg, out of Luxembourg etc) may potentially lead to a negative tax impact where an existing UCITS management company has tax losses carried forward.

Fund level

The location of the management company in Luxembourg should have no impact on the residence of the fund.

Investor level

No taxation of unrealized gains at investor level may arise as long as the potential change in tax residency of the UCITS fund would not imply the disposal of the shares/units

II) Merger

Fund level

At the level of the Fund, an inbound or outbound merger should not trigger taxation (i.e. in relation to unrealized capital gains) as the funds are not subject to capital gains tax in Luxembourg.

Investor level

At the level of the investor, the merger should be considered as a sale of shares followed by an acquisition of new shares, which may trigger taxation.

III) Master – Feeder

Fund level

No income taxes will be due as all form of funds are not subject to income tax. In addition, feeder and master Funds should only be subject to subscription tax at one level if both are in Luxembourg.

In the case that the master fund is located in Luxembourg, there would be, in principle, no withholding tax on payments made by the master fund to the feeder fund.

Fund level

In case a Luxembourg feeder fund invests cross-border into a master fund set up in another EU country, the Luxembourg feeder fund will be subject to a subscription tax.

The redemption of fund units held by a foreign feeder in a Luxembourg Master is in principle not subject to taxation. However, in case double tax treaty protection is not available, if a non-resident feeder fund, which has a participation of at least 10% in a Luxembourg incorporated master fund (SICAV only) realizes, less than 6 months after its acquisition, a capital gain on the sale of its participation, such feeder fund will be taxed in Luxembourg (so-called "speculation" gain). However, as the Luxembourg government has announced a change in Luxembourg tax legislation, we anticipate that no taxation should occur in the future.

Investor level

No taxation should in general be triggered upon transformation of a Luxembourg master into a feeder fund as long as investors keep their shares in the feeder fund.

Victor Mendoza

Spain

"UCITS IV may stimulate a change on Spanish Tax rules to eliminate uncertainty on the tax residence of non-Spanish contractual funds being managed remotely in Spain. Spain's quite simple system to tax Funds as well as the friendly access to Treaty coverage for Contractual and Non-contractual funds helps make Spain an attractive jurisdiction for Master Funds"

I) Single Management Company

Management Company level

Under UCITS IV it is possible to transfer an existing management company from/ to Spain and as a result certain tax issues may arise. The transfer of an existing management company out of Spain could give rise to a taxable event unless the assets and liabilities remain assigned to a permanent establishment (PE). The transfer of an existing management company into Spain would subject its worldwide income to Spanish Corporate Income Tax at a 30 percent rate.

The transfer of activities will have tax impacts, in the case of a partial or full transfer of functions outside Spain. Where all the assets and liabilities (and consequently the functions) remain assigned to a Spanish Branch, tax neutrality could be achieved by applying the Mergers Directive. The transfer of a management company to Spain may not be considered neutral in the event the effective tax rate of the management company is lower in the transferor country of residence.

Fund level

The transfer of a management company could give rise to potential tax residence issues as long as its tax residency is relevant to determine the fund's tax residency. A Spanish manager of a non Spanish UCITS can make the non Spanish UCITS tax resident in Spain. Corporate funds would be in a better position to remain tax resident in their country of incorporation as they have their own "asset management body", i.e. the Board of Directors. Spanish tax resident funds are taxed on their worldwide income at a 1 percent tax rate.

As a result, where a non Spanish contractual fund becomes tax resident in Spain, it may not be tax neutral as long as Spanish tax resident funds are taxable entities at a 1 percent tax rate.

Investor level

No taxation of unrealized gains at investor's level should arise as long as the potential change in the tax residency of the UCITS fund would not imply the disposal of the shares/units.

Dividend distributions from the Spanish tax resident fund to a foreign investor will be subject to 19 percent withholding tax or reduced treaty rate if applicable. Redemption / Transfers could be taxable in Spain in the event of Non-EU investors not covered by a DTA.

II) Merger

Fund level

From a Spanish regulatory and commercial point of view, at present Spanish funds

may be merged both with funds or sub-funds provided merged funds correspond to the same class (financial/non financial). That is to say that the regulatory rules on domestic mergers of funds will not allow a merger of e.g. an equity fund (financial) with a real estate fund (non financial). Normally no Spanish tax issues arise for the fund, as long as the funds are taxed on a mark-to-market basis, and thus upon a merger there would be no unrealized capital gains or hidden reserves.

Investor level

In respect to the investor, a tax neutral event would depend on whether or not the merger is carried out under a transaction covered by the Spanish tax neutrality regime with the following characteristics:

Domestic Merger – Merger of funds or subfunds belonging to different funds are considered tax neutral for the investor. However, mergers of subfunds belonging to the same fund are not entitled to apply the regime to the extent that they do not have an independent character for tax purposes.

Cross-border Merger - It is relevant in such a case to determine whether the merger is carried out between entities adopting a listed legal form as per the annex of the Merger Directive 90/434/EEC. Certain restructuring operations (Contractual Fund-Contractual Fund or Corporate Fund-Contractual Fund) might not achieve tax neutrality. This could be considered discriminatory when a merger of Spanish funds is generally tax neutral for the investor.

III) Master – Feeder

Fund level

Master-feeder funds are taxed under the same special tax regime applicable to other funds (at a 1 percent tax rate).

Dividend distributions from the Spanish Master fund to a feeder fund located in another Member Sate would be subject to 1 percent taxation on net basis. Standard 19 percent withholding tax will be applied at source and the foreign feeder will have to claim a refund from the Spanish tax authorities by filing the relevant claim forms. Redemptions/transfers will generally be exempt from withholding tax in Spain. However uncertainty on the application of the exemption exists in case of a non treaty FCP holding participations in the Spanish master for 25 percent or more.

Investor level

No taxation will be triggered in Spain at investor's level to the extent that the investor will keep units/shares of the same Fund. This is the case for a local feeder and a foreign master and vice versa.

Sweden

"Sweden plays an important role in the European fund market. To make the Swedish investment funds more competitive, the Swedish Ministry of Finance as a consequence of the UCITS IV Directive appointed a committee with the assignment to analyze the possibilities to transfer the taxation of funds to investor level and to propose necessary changes to the law. The committee published their conclusions in January 2010 and its proposal is now being discussed. However, further changes will be required in order to ensure that the advantages of the UCITS IV Directive may be fully utilized."

Ann Torner

I) Single Management Company

Fund level

The tax residency of a Swedish management company should not influence the tax residency of a foreign fund. However, depending on the circumstances the foreign fund might be seen as having a permanent establishment in Sweden.

Since Swedish investment funds are contractual there is a small risk that a fund would be seen as tax resident in the country of its "effective management", i.e. where its foreign management company is tax resident.

Investor level

No disclosure of unrealized gains at investor's level.

II) Merger

Fund level

There are no Swedish tax rules on cross-border fund mergers.

A merger between Swedish funds does not entail any Swedish tax consequences for the funds. Under general current rules there is a possible risk for tax consequences in case of a cross-border merger. This would be discriminatory unless new rules follow the implementation of the UCITS IV Directive.

Investor level

There are no Swedish tax rules on cross-border fund mergers. The current tax rules only cover mergers between Swedish funds only or between foreign EES domiciled UCITS funds only.

A merger between Swedish funds does not entail any Swedish tax consequences for the investors. As regards a merger between foreign EES domiciled funds that are UCITS there are no Swedish tax consequences for the investors provided that the merger is in line with the legislation in the foreign country.

Potential taxation could arise when merging cross-border, since no rules currently exist, see above. This would be discriminatory unless new rules follow the implementation of the UCITS IV Directive.

III) Master – Feeder

Fund level

In case of a Master-Feeder structure, a Swedish Master would normally withhold tax on dividends paid to a foreign Feeder. The withholding tax depends on the legal form of the foreign Feeder and the qualification as foreign legal entity under the Swedish Withholding Tax Act. The Swedish withholding tax on certain foreign funds may be discriminatory.

Potential CFC rules might also be applicable in case a Swedish Feeder would invest in certain foreign Masters, if the holding is more than 25 percent.

Investor level

No taxation will be triggered in Sweden at investor's level to the extent that the investor keeps the units of the same fund. In case however that the investor receives an additional cash amount as mentioned in the Directive, there is a taxation risk.

Rachel Hanger

United Kingdom

"In order to avoid the risk that foreign funds could be taxed in the UK when managed by a UK single management company, we urge HM Treasury to exempt UCITS funds from the long-established residence tests as Ireland has recently done. Some technical aspects of the UK legislation will need to be updated to allow for Master-Feeder structures including the fund specific Genuine Diversity of Ownership. However, the UK is attractive as a location for master funds due to its ability to access over a hundred tax treaties and we welcome the announcement in the 2010 Budget that the Government will look to remove an SDRT obstacle to feeder funds and consider introduction of a contractual fund framework in the UK."

I) Single Management Company

Management Company level

The transfer of an existing management company out of the UK could give rise to taxation on gains unless the assets and liabilities remain assigned to a permanent establishment (PE). The transfer of an existing management company into the UK would subject its worldwide income to corporation tax at a 28 percent rate.

Fund level

The UK corporate residence rules create uncertainty for management companies wishing to manage non-UK funds remotely. A company is resident in the UK if incorporated in the UK, or if its central management and control is exercised from the UK. If the fund is dual resident, double tax treaties tend to look to the place of effective management. If a corporate UCITS becomes resident in the UK it is likely to be subject to tax as an ordinary company i.e. with income and gains subject to corporation tax at 28 percent.

Provided that the non-UK fund has a board that exercises central management and control from outside the UK, this risk can be managed.

The position of unit trusts is less clear as, although they are deemed to be companies for the purposes of the Taxation of Capital Gains Act 1992, they have a very different legal structure. The position for contractual funds is even less clear because the UK does not have a complete tax, regulatory or legal regime for contractual funds. As the UK tax authorities typically regard contractual funds as transparent, the direct tax and VAT effects of having a UK management company for foreign funds are potentially complicated.

Trading funds (the presumption is that most UCITS funds do not carry on trading activities for tax purposes) have an additional risk that management from the UK could create a PE of the fund. There is an established safe harbor, the Investment Manager Exemption, which applies provided that the manager and fund are independent of one another.

Investor level

A transfer of the management company would not typically have any tax implications for UK resident investors unless it resulted in a transfer of residency of the UK fund outside of the UK. In this situation, if it was then necessary for the fund to obtain UK distributor/reporting fund status and this was achieved, UK investors would be in broadly the same position as before.

II) Mergers

Fund level

To the extent that UK equities are transferred from the discontinuing to the continuing fund, a scheme of arrangement ought to qualify for relief from UK stamp duty and stamp duty reserve tax ("SDRT"). The position is clear for mergers of UK funds, however, it is unclear for mergers on a cross-border basis and an approach to HMRC would be recommended.

Investor level

There are established rules providing relief for UK investors when corporate funds or unit trusts merge. Provided that the merger qualifies as a "scheme of reconstruction", or is structured as a share for share exchange, a tax charge or loss is not crystallized on merger.

Mergers of UK funds are typically carried out as Financial Services Authority ("FSA") schemes of arrangement that qualify as schemes of reconstruction. (Scheme of reconstruction is a tax definition, whereas scheme of arrangement is a regulatory term.) There are certain criteria to meet to fall within the scheme of reconstruction tax definition.

Also, the merger must be for bona fide commercial purposes to enable those with a greater than a 5 percent holding in the discontinuing fund to qualify for this treatment. It is common practice to seek clearance from HM Revenue and Customs that this is the case and generally FSA approved schemes of arrangement (or non-UK equivalent schemes) ought to qualify.

The treatment should therefore be straightforward when the merger is equivalent to a scheme of arrangement and involves corporate funds or unit trusts. However, the following complications could arise with non-UK funds:

1) If the event is to be tax neutral for investors, the merger must meet the scheme of reconstruction definition above or qualify as a share for share exchange.

2) The continuing and discontinuing funds are likely to seek distributor status to help ensure that UK investors are subject to capital gains rather than income tax on disposals. If the discontinuing fund does not have distributor status but the continuing fund does have distributor status, an income tax charge is crystallized.

3) The treatment of contractual funds has changed from 1 December 2009 so the capital gains tax treatment for UK individuals should be on a par with that in respect of corporate funds and unit trusts.

4) The ongoing tax treatment must be considered - the treatment of UK investors in a non-UK UCITS ought to be broadly equivalent to that of UK investors in a UK UCITS provided that the non-UK UCITS qualifies for distributor status. In broad terms, UK retail investors are not accustomed to investing in contractual funds, which are treated as transparent as far as income is concerned, and are used to receiving composite dividends rather than streamed information.

III) Master Feeder

Fund level

As far as the ongoing position is concerned, the preferred master funds are likely to be tax transparent so that they do not distort the withholding tax analysis of the feeder funds. For example, if the feeder funds are resident in DTA countries and the master fund is resident in a non-treaty country, a higher rate of withholding tax is likely to be applied by some countries of investment. UK funds can be sensitive to this, as they tend to qualify for DTA benefits.

The UK does not have an appropriate transparent UCITS vehicle. However, if transparency is not important, authorized unit trusts or open-ended investment companies could give a favorable outcome. As above, they tend to qualify for treaty benefits and do not impose withholding tax on distributions to corporate feeder funds or unit trusts.

UK Feeder funds will need clarification as to how to account for returns from master funds. To the extent that the master fund is transparent, there could be discrepancies between information in the accounts of the feeder fund and the information the fund needs to complete its UK tax return.

More technical aspects of the UK legislation will need to be updated to allow for master/feeder structures, for example the genuine diversity of ownership rules that apply to some authorized funds. The 2010 Budget announced changes to the fund-specific SDRT rules; these changes are expected to remove an obstacle to UK feeder funds.

Investor level

A UK feeder should not give rise to new tax concerns at investor level.

To the extent that an existing fund range is being converted to a master / feeder structure, similar matters arise as for mergers. These points are covered above.

Appendix 1

Different types of funds existing in the EU Member States based on the categories stated under UCITS IV

	Type of funds		
Country	Corporate funds	Contractual funds	Unit trusts
Austria		✓	
Belgium	✓	✓	
Bulgaria	✓	✓	
Cyprus	✓	✓	✓
Czech Republic		✓	
Denmark	✓		
Estonia	✓	✓	
Finland		✓	
France	✓	✓	
Germany	✓	✓	
Greece	✓	✓	
Hungary	✓		
Ireland	✓	✓	✓
Italy	✓	✓	
Lithuania	✓	✓	✓
Luxembourg	✓	✓	
Malta	✓	✓	
the Netherlands	✓	✓	
Poland	✓		
Portugal			✓
Romania	✓	✓	
Slovakia		✓	
Slovenia	✓	✓	
Spain	✓	✓	
Sweden		✓	
UK	✓	✓	✓

Source: KPMG International, March 2010

kpmg.com

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