THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2019

MODULE 3.05 – BANKING OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Treatment of Bank Beta

Bank Beta is booking client holdings in its branches in Jersey and Hong Kong. Irrespective of their status as branches in these jurisdictions, these entities are subject to the FATCA & CRS regulations enacted in Jersey and subject to the Model 2 FATCA IGA and the enacted CRS regulations in Hong Kong.

Bank Beta must determine their status under each of these regulations. Given the limited information provided, Bank Beta is a Foreign Financial Institution (FFI) in accordance with FATCA or a Financial Institution in accordance with CRS.

Bank Beta is described as providing custodial services and offering Discretionary Portfolio Management propositions to clients. Based on this information, the entity will be a Financial Institution, the following considers the Financial Institution sub-classification definitions to determine which applies.

A Custodial Institution – any entity that holds as a substantial portion of its business, financial asset for the account of others, where a substantial portion equals or exceeds 20% during the shorter of the last three years ending on 31 December prior to the year of determination or the period for which the entity has been in existence;

Or,

An Investment Entity – an entity that conducts as a business (or is managed by an entity that conducts as a business) one or more of the following:

1. Trading in money market instruments, foreign exchange, interest rate and index instruments, transferable securities or commodity futures;

2. Individual and collective portfolio management; or,

3. Otherwise investing, administering or managing funds or money on behalf of other persons.

The definitions provided are taken from the Jersey FATCA IGA and are consistent with the Hong Kong IGA. However an entity may use relevant US Treasury Definitions when to do so would not frustrate the purpose of the Agreement. Under the Treasury Regulations the definition of an Investment Entity is modified as follows:

- The entity primarily conducts as a business one or more of the following activities or operations for or on behalf of a customer (1) trading in money market instruments, foreign currency, foreign exchange, interest rate and index instruments, transferable securities, commodity futures; or, (2) individual or collective portfolio management; or, (3) otherwise investing, administering, or managing funds, money, or financial assets on behalf of other persons; or

- The entity's gross income is primarily attributable to investing or trading in Financial Assets and the entity is managed by another entity that is a Financial Institution. For purposes of this paragraph an entity is managed by another entity if the managing entity performs, either directly or through another third party service provides any of the activities described in (a) on behalf of the managed entity;

- The entity functions or holds itself out as a collective investment vehicle, mutual fund, exchange e traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund or similar investment vehicle established with an investment strategy of investing, reinvesting or trading in Financial Assets.

Financial Assets for this purposes of this definition include cash and real property.

For CRS, utilising the OECD published text, an investment entity is an entity that primarily conducts as a business one or more of the following activities or operations for or on behalf of a customer:

- Trading in money market instruments, foreign exchange, interest rate and index instruments, transferable securities or commodity futures;

- Individual and collective portfolio management; or,

- Otherwise investing, administering or managing funds or money on behalf of other persons.

Alternatively, the gross income of which is primarily attributable to investing, reinvesting, or trading in Financial Assets, if the entity is managed by another entity that is a Depositary institution, a Custodial institution, a Specified Insurance Company, or an Investment Entity as described above.
For the purposes of the two alternatives above, 'primarily' is taken to mean when the gross income attributable to the relevant activities equals or exceeds 50% of the entity's gross income for the shorter of the last three years ending on 31 December prior to the year of determination or the period for which the entity has been in existence.

For the purposes of CRS financial assets do not include real property.

From the IGA, FATCA Regulations and CRS definitions it can be seen that both branches of Bank Beta are FFI's under FATCA and RFI's under CRS by virtue of being a Custodial Institution or an Investment Entity. Without further information regarding the predominance of activity or the nature of the business it is not possible to clarify which sub-classification applies. As an FFI / RFI. Bank Beta is obliged to report account holder information in accordance with the regulations.

<u>Jersey</u>

Bank Beta must report:

FATCA

All individual account holders who are US Specified Persons and all non-US entity's having one or more Controlling Persons that is a Specified Us Person directly to the Jersey Competent Authority.

CRS

All individual account holders that are Reportable Persons and all entity's with one or more Controlling Persons that is a Reportable Person directly to the Jersey Competent Authority.

<u>Hong Kong</u>

Bank Beta must report:

FATCA

1. Report on an aggregated basis all US Persons who do not provide a TIN and do not give consent to report directly to the US Tax Authorities.

2. Provide information on each US Account held by one or more US Specified Persons and all non-US entity's having one or more Controlling Persons that is a Specified US Person directly to the Hong Kong Competent Authority.

3. Exchange information in accordance with a group request made pursuant to Article 5 of the Tax information Exchange Agreement between the US Competent Authority and the HK Competent Authority, providing information regarding non-consenting US accounts and foreign reportable amounts paid to Non Participating FFI.

CRS

All individual account holders that are Reportable Persons and all entities with one or more Controlling Persons that is a Reportable Person directly to the Jersey Competent Authority.

<u>Plausible classifications of the Client Accounts</u>

From the question it can be seen that the clients hold securities in nominee accounts and also hold discretionary portfolio management (DPM agreements). It is not clear from the question if the securities held in custody are included within the DPM, however regardless of the status of such securities the following will show that this will not affect the classification of the clients.

CRS

As stated earlier an Investment entity includes an entity the gross income of which is primarily attributable to investing, reinvesting, or trading in Financial Assets, if the entity is managed by another entity that is a Depositary institution, a Custodial institution, a Specified Insurance Company, or an Investment Entity described in (a), where (a) includes Individual and collective portfolio management. To aid in providing clarity the Commentary also confirms that an entity would be considered an investment entity if it functions or holds itself out as a collective investment fund, hedge fund, venture capital fund, leveraged buy-out fund, or any similar investment vehicle established with an investment strategy of investing, reinvesting or trading in Financial Assets.

From this the primary conditions for the classification of the client accounts as an investment entity are:

1. The income is primarily attributable to reinvesting or trading in financial assets;
2. The entity is managed by another entity that is a Financial Institution

From the analysis in part (1) of this question, Bank Beta has been determined as an FI, which is either a Custodial Institution or an Investment Entity meeting primary condition (1) above.

The additional condition being that that the entity is 'managed by' another entity, is clarified in the Commentary to the CRS which specifies that if the managing entity performs either directly, or through another service provider, any of the activities or operations described in (a) [see earlier] on behalf of the managed entity, however this is limited in that the managing entity must have discretionary authority to manage the entity's assets in whole or in part.

The OECD published FAQ's addressing the question of 'managed by', confirming that an entity that invests all or a portion of its assets in a mutual fund, exchange traded fund or similar vehicle will not be considered 'managed by'.

From this in both the case of Jersey and Hong Kong it can be seem that the clients of Bank Beta who hold a DPM exclusively or in conjunction with other accounts held with Bank Beta are likely to be Investment Entities for CRS purposes i.e. 'Professionally Managed Investment Entities', however in concluding on this classification the account holder must consider the degree to which Bank Beta has discretionary authority to manage the assets as opposed to investing the assets in a widely available fund, without regard to the individual needs and circumstances of the client.

FATCA

In accordance with the US Code an entity is an investment entity and a Financial Institution if the entity's gross income is primarily attributable to investing, or trading in financial assets and the entity is managed by another entity that is a depositary institution, custodial institution, insurance company, or an investment entity.

The Model 2 IGA places reliance on the US IRS regulations directly and therefore can rely on any additional guidance provided. Model 1 IGA's standalone without reference to the US Code although they make provision for the use of US Regulation definitions where this does not frustrate the Agreement.

To this end the regulations provide a range of examples to explain the managed by category showing that this covers entities receiving specific professional management advise from an advisor that is tailored to the investment needs of the entity. This guidance was enhanced in December 2018 when the IRS issued 'Regulations Reducing Burden under FATCA and Chapter 3' which provided further clarity in respect of the application of 'managed by'. The additional regulations confirm that a Financial Institution does not have discretionary authority over an entity merely because it sells the entity shares in a widely-held fund that employs a pre-determined investment strategy. This guidance goes on to advise that a mutual fund, exchange traded fund or a collective investment entity that is widely held, would not meet the discretionary management requirement

The definition confirms that this is similar to the guidance published by the OECD in interpreting the definition of a 'managed by' investment entity under CRS.

From this similar to the CRS Regulations it can be seen that a plausible classification under FATCA for a client account would be - Financial Institution by way of being Investment Entities. However this would be subject to the DPM falling within the limitations provided.

FATCA provides an additional classification which can apply in the given circumstances, it has been established to address the onerous burden that falls on an entity determined as an FFI by way of being classified as an Investment Entity. The alternate classification which is taken from the US regulations rather than being included in the IGA is an Owner Documented Foreign Financial Institution (ODFFI). As ODFFI is not part of the regulations it is electable for the Foreign Financial Institution to provide this as an option as the classification ODFFI place the onus of reporting on the FFI itself rather than on the client which has bene determined as an Investment Entity. The ODFFI is only applicable under certain circumstances and requires that the account provides an Owner Reporting Statement with full information of all equity interest holders both US and Non US and all Debt holders in excess of 50,000 USD.

From the above it is clear that for FATCA purposes ODFFI is also a plausible classification.

Question 2

Part 1

The corporate criminal offence ("CCO") was brought into force by the Criminal Finances Act 2017 make businesses criminally liable if their "associated persons" facilitate tax evasion by a taxpayer either in the UK or overseas. The offences were modelled on the corporate "failure to prevent bribery" offence in the Bribery Act 2010.

One of the key aims of the legislation was to ensure that a company could be prosecuted company when its employees facilitate tax evasion by their customers or suppliers. The CCO targets the failure to prevent the crimes of those who act for or on behalf of a corporation.

There are two stages for the new corporate offences to apply:

1. Criminal tax evasion (not tax avoidance) must have taken place; and
2. The associated person with the business must have criminally facilitated the tax evasion whilst performing services for that business.

For either of the offences to apply, the employee or associated person must have criminally facilitated the tax evasion, in its capacity as an employee or associated person, providing services to Globebank. GlobeBank cannot be criminally liable for failing to prevent the facilitation of tax evasion if the facilitator was acting in a personal capacity.

If stages one and two above have occurred i.e. criminal tax evasion that has been criminally facilitated by a person associated with the business, the business will have committed the new FTP offences. GlobeBank will have a defence if it can prove that it had put in place reasonable prevention procedures to prevent the facilitation of tax evasion taking place. HMRC 6 guiding principles.

As part of HMRC's approach to dealing with this new offence, it has given details of how a company or partnership can 'self-report' any acts of criminal facilitation that it has discovered. The procedure involves an email being submitted to HMRC by an individual authorised by the company/partnership~~.~~

Globebank will have to undertake a risk assessment to identify the risks of facilitation of tax evasion within the organisation and the potential gaps in the existing control environment. The risk assessment should be documented so that it can provide an audit trail to support any policy decisions regarding the implementation of new procedures to reduce the risk of exposure to FTP.

The penalties for the CCO include unlimited financial penalties. In addition, the penalties include and ancillary orders (such as confiscation orders or serious crime prevention orders).

<u>Who can commit the CCO offences and for whose actions are they responsible?</u>

It is only possible for a relevant body can commit the new offence. A relevant body is defined as a 'a body corporate or a partnership', wherever incorporated or formed. Therefore, this includes all legal persons such as companies, partnerships and LLPs and charities. Individuals cannot commit an offence under the CCO.

There is no requirement that the relevant body needs to have benefitted from the facilitation in any way to commit the offence. A relevant body can only commit the new offences if a person associated with it criminally facilitates a tax evasion offence-either deliberately or dishonestly.
An associated person is defined as "a person" who "performs services for or on behalf" of a "relevant body", either an employee, an agent of the relevant body, or a person acting in any of these identified capacities. The definition of an associated person is intended to be broad in scope to ensure that both employees but also contractors or sub-contractors are captured by the legislation.

What is Dual criminality within in the context of the CCO?

The failure to prevent the facilitation of non-UK tax evasion would be an offence under s.46 of the Act where the financial institution has a UK connection.

However, different countries approach the criminalisation of taxpayer non-compliance differently, an offence will only be committed where it meets a requirement of dual criminality. In the first instance, the offence is a criminal offence in the country where it is committed (s.46(5)(a)), but also the offense would need to be considered as the fraudulent evasion of tax in the UK (s.46(5)(c)).

In addition, the facilitation offence must be a criminal offence in the jurisdiction that it is committed (s.46(6)(a)) and would, if the foreign tax evasion offence were a UK tax evasion offence, also be a tax evasion facilitation offence in the UK (s.46(6)(c)).

Part 2

The CFO has become increasingly concerned with Globe bank falling within scope of the bank levies not just in the United Kingdom but also bank levies in other jurisdictions.

The UK bank levy is an annual tax on certain liabilities of the majority of UK-based banks and building societies. The levy is not charged on the first twenty billion of chargeable liabilities, in addition it is not deductible for corporation tax purposes.

For 2018 the tax was levied at 0.16% of a bank's short-term relevant liabilities, and 0.08% of long-term equity and liabilities. In addition, staged reductions down to 0.10% and 0.05% by 2021 are proposed.

The second change was that a new 8 per cent corporation tax surcharge on the profits of banks (where bank had an annual profit in excess of £25 million), in addition to existing corporation tax, came into force on 1 January 2016.

Paragraphs 66(1)(a) refers to double taxation relief ("DTR") being afforded in respect of any "equivalent foreign levy". To resemble to the UK bank levy and therefore treated as an equivalent foreign levy what characteristics must the foreign levy have?

The foreign levy must approximately follow the proposals for the design of bank levies in the 2010 paper "a fair and substantial contribution by the financial sector".

In addition, the foreign levy must also be based a levy that is based on the balance sheet assets or liabilities and be in similar intent to the UK levy.

Should the foreign levy be a tax on income, profits or gains HMRC will not conclude that the overseas levy is an equivalent foreign levy and DTR will not be available.

PART B

Question 3

The Section 871(m) regulations were introduced in 2010 the same time as the FATCA regulations, however they only were with effective from 1 Jan 2017, reflecting their inherent complexity.

871m ensures that non-US Persons using financial derivatives are subject to US withholding tax through the introduction of a new term “dividend equivalent payments” which are treated as US-source income and therefore subject to US withholding tax when applied to non-US persons.

The following will consider each of the pertinent 871m elements

- The IRS includes
- In scope instruments

The regulations identify three derivative types defined in the US tax code which could be deemed in-scope:

- Equity-linked instrument (ELI) – this is a financial transaction that references the value of one or more underlying securities and includes futures, forwards and options (an ELI does not include securities lending or repo transactions).

- Notional Principal Contract – this is an instrument that provides for the payment of amounts at specified intervals calculated by reference to a specified index in exchange for specified consideration or a promise to pay similar amounts. AN NPC includes equity swaps and equity index swaps.

- Securities lending or sale- repurchase contracts or substantially similar transaction that references an underlying security.

Defining a Section 871(m) Transaction

A potential Section 871(m) transaction is any securities lending or sale-repurchase transaction, NPC or ELI that references one or more underlying securities which could give rise to a US source dividend.

Where the potential 871m transaction has a delta of 1, the long party to the transaction is subject to US withholding tax in accordance with Chapter 3 of the US IRS regulations in the event of the payment of a dividend equivalent amount that references a dividend from an underlying security pursuant to a securities-lending or sale-repurchase transaction, an NPC or an ELI.

The determination of an 871m based on delta 1 continues to apply under transitional relief until 2021. Post transitional relief the regulations provide for the application of delta 0.8, which will substantially extend the applicable scope of Section 871(m).

Limitations in the application of Section 871m

The regulations grandfather potential Section 871(m) transactions in existence before 1 January 2017, unless they are subject to material variation and provide a safe harbour for qualifying indices that are widely used and based on a diverse basket of publicly traded securities and for pre-existing Exchange Traded Notes specifically listed due to the difficulty in determining new issues post 1 Jan 2017 given their fungible state.

The regulations take account of the potential for abuse by including provision for combined transactions and substantially similar transactions although the application of these regulations is deferred until 2021 under transitional regulations. The regulations also give relief for the overlap with s305c transactions where the long party holds the underlying stock.

Roles and Responsibilities under Section 871(m)

The regulations define a Responsible Party as a broker or dealer transacting with a counterparty that is not a broker or dealer and in the event that both parties or neither parties to the transaction are brokers or dealers, the short party to the transaction is the responsible party. The Responsible Party is obliged to determine whether the transaction is a Section 871(m) transaction and is required to determine and report to the counterparty the timing or amount of any dividend equivalent. If requested by any party to the transaction, the Responsible Party is required to provide information regarding delta, the dividend equivalent amount and tax withheld and deposited.

The Responsible Party's determination is binding.

Interaction with Qualified Intermediary (QI) Agreement

The QI Agreement obliges a QI which is a Qualified Derivatives Dealer to assume primary withholding responsibility for purposes of Chapter 3 and Chapter 4 for all payments it makes as a QDD and must withhold on the dividend payment date for the applicable dividend. This regulation can result in cashless withholding. All such withholding will be subject to treaty relief where applicable

Section 871(m) in conjunction with the QI Agreement provides for the QDD Tax Liability, which is:

- the sum of its liability to tax on its Section 871(m) amount reduced by the amount of tax paid on dividends received in its capacity as an equity derivatives dealer, but not below zero; plus

- tax liability for dividend equivalent payments received in its non-equity derivatives dealer capacity; plus

- tax liability for any payments received as a QDD with respect to potential 871m transaction that are not dividend equivalent payments to the extent this has not been previously satisfied.

Under transitional relief a QDD will not be subject to withholding on dividend and dividend equivalent amounts received in its equity derivatives dealer capacity or subject to withholding on dividends until 2022.

Question 4

Describe the different possible approaches for establishing the free capital attributable to the permanent establishment ("PE") a bank under the authorised OECD approach ("AOA") (OECD report on attribution of profit to PEs 2010)).

The overall principles and approaches governing the allocation of capital to permanent establishments ("PEs") are contained in part 1 of the 2010 OECD report on the attribution of profits to PEs. Part 2 of the PE report describes the specific approaches to the capital attribution of PEs of banks under the authorised OECD approach (AOA).

Assuming in fact the branch is performing of all the risk related management activities for the financial assets, the AOA discusses a number of possible methods to allocate capital of the whole banking enterprise to the branch.

The overall approach is to treat the branch as if it were a separate enterprise. This approach is potentially workable only if the risk weighting of the assets of the branch accounts for the portfolio effect, otherwise excess capital will be attributed to the branch. Three methods are proposed by the Bank PE guidance.

The first of these is the capital allocation approach involves allocating the bank 's genuine free capital in accordance with the attribution of financial assets and risks. This is done by first attributing assets and risks and then risk-weighting the assets (RWA) of the entity as a whole by following the Basel standardised regulatory rules (the BIS ratio approach).

For example, if the PE has 10% of the bank 's risk-weighted assets, it will have attributed to it 10% of the bank 's —free capital i.e. this method means that the PE necessarily has proportionately the same composition of regulatory capital as the whole bank.

If capital allocation approaches are to be used as a method for the application of the arm's length principle it is necessary to correctly allocate the total free capital of the bank, and not just the regulatory minimum. This is on the basis that all the assets and all the associated risks of the bank have been attributed to the various parts of the bank, including the head office, under the functional analysis.

The capital allocation approach is relatively easy to administer; although it should be noted that it may depart from the arm's length standard if separate companies within the group are required to maintain different levels of capital.

There are also alternatives within the capital allocation approach that do not entail risk weighting the assets according to a standardised regulatory approach. Instead they rely on the banks internal risk models. These models are satisfactory under the AOA, as long as that they are approved by the regulators, applied consistently and adequately documented.

The economic capital allocation approach is an example. This method relies on the banks internal measure of risk and economic capital; however, the OECD consider that such measures do not appear to be very well developed even in banking institutions that have very sophisticated risk measurement systems" (OECD report on attribution of profit to PEs (2010))
The second approach is the thin capitalisation approach that requires a comparison of the branch's portfolio of assets with that of separate enterprises operating under same or similar conditions in the jurisdiction; such an approach is costly and arguably not comparable if the separate enterprise is limited in its activities because of separate capital requirements.

So, if the PE has 15% of the enterprise's assets and/or risks it will have attributed to it 15% of the enterprise's free capital.

The OECD note as a criticism of this method that when the bank PE is hypothesised as a separate enterprise would be smaller than the bank. As a result, it maybe be compared with similarly smaller independent banking enterprises. However, small independent banks are unlikely to be comparable to a PE that is part of a large banking enterprise- in that they are likely to carry on different business and have different risk appetites and creditworthiness. So, the small independent banks may not be a reliable benchmark.

A third approach that could be used is the alternative safe harbour approach, or sometimes referred to as the is called the quasi thing capitalisation/regulatory minimum capital approach. This approach requires the branch to have at least the same minimum amount of free capital as the domestic regulator would set for an independent banking enterprise operating in the same host country. The regulatory minimum free capital would be established in accordance with the regulatory standards and the domestic tax legislation rules of the host country.

This approach ignores that the PE generally has the same creditworthiness as the Head office, for this reason the approach is not considered an authorised capital attribution approach. However, it may be satisfactory as a safe harbour if the outcome is not the attribution of profits to the PE that are beyond the range of profits that would result if one of the authorised OECD approaches to capital attribution had been applied.

A key problem of this approach is that if you only attribute the regulatory minimum capital for the countries where the banks has PEs any free capital will be by default allocated to the head office-which is not in line with the arm's length principle.

Delta Bank Ltd has a Tier 1 equity capital of £5,600m. The risk weighted assets (RWA) are £28,000m.

Its foreign PE has RWA of £2,800m.

Comparable independent banks in the country of the PE have a Tier 1 ratio of 15% while the regulatory minimum is 11%.

<u>Delta Bank Ltd Balance sheet (£m)</u>

Risk weighted assets	28,000	Tier 1 Capital	5,600
Other assets	4,000	Debt	26,400
	32,000		32,000

Capital allocation approach/BIS ratio:

- Delta Bank Ltd has a Tier 1 capital ratio of 20% (5,600/28,000 *100).
- The BIS ratio for the capital allocation approach would be 10% and the PE would need to be attributed 10% of the banks Tier 1 capital.
- So the PE would have the same Tier 1 capital ratio of 20% as the bank as a whole i.e. £560m.

Thin capitalisation approach:

- The PE would have an equity capital of £420m (£2,800m *15%) i.e. tier 1 ratio of 15% in line with independent banks carrying on similar activities in the PE host country.

Regulatory minimum capital:

- The regulatory minimum capital ratio in the PE host country, in this example £308m (2800m *11%).

The terms back and middle office are commonly used to define support functions in a banking environment, for example trade settlement, IT or finance. However, there is nothing contained within the authorised OECD approach that requires attention to be given to such distinctions.

The authorised OECD approach is concerned with identifying the key entrepreneurial risk-taking functions without regard to the label given to the function or activity but based on a functional and factual analysis. If an activity is considered a key entrepreneurial risk-taking function will be contingent on the facts and circumstances of the business.

PART C

Question 5

The Japanese Bond Income Exemption scheme was introduced in 2010 extending and simplifying the existing Japanese Government Bond exemption scheme to include corporate bonds held in book-entry form with the Bank of Japan (BoJ) or JASDEC as the Book-entry transfer institution.

To qualify as a bond in the Book-entry system, the bond must be recorded in the Book-entry transfer ledger at a Japanese branch of a BoJ participant in the book-entry system; or at a specified foreign branch of a foreign financial intermediary that is resident in a country whose treaty with Japan provides for the exchange of information. Such institutions are called Qualified Foreign Intermediaries (QFI's), as a Global Custodian Bank Gamma would potentially be such an institution. To become a QFI Bank Gamma must apply for pre-approval by the BoJ and the Nihombashi Tax Office for the purposes of JGB exemption.

Bonds which meet the prescribed Book-entry criteria are subject to tax exemption on income and on profit-on-redemption, including profit-on-redemption of T-Bills and STRIPS, when paid to non-resident individuals and foreign corporations.

The procedures that must be followed are:

QFI Approval

The QFI must be pre-approved by the BoJ and the District director of the Nihombashi Tax Office. A QFI must also register with the National Tax Agency as a Foreign Indirect Participant if it wishes to hold JGB in custody on behalf of its customers through the account of another QFI.

Bondholder Documentation

If the JGB's are held within a transfer account with a Qualified Foreign intermediary (QFI), the non-resident individual or foreign corporation must provide an application form plus identification documentation issued by the taxing authority where the non-resident is domiciled.

For an individual this will include:

- a tax registration certificate;
- receipt/ certificate for payment of taxes/ social insurance; or,
- a document issued by the Government or public offices.

For an entity this will include:

- a certified copy or abstract from the register of companies, certificate of a seal impression;
- a receipt/ certificate for the payment of taxes/ social insurance; or,
- other document issued by the government or public office.

The documentation provided must not be dated more than six months prior to the date of its presentation. If the applicant is a foreign investment trust the relevant prospectus must be provided.

If the non-resident is a partnership or trust, the documentation must be provided for all the partners and beneficiaries.

The application form must be resubmitted every five years unless there is a change in the information in which case an application amendment form must be provided, which will reset the elapsed time clock, providing another five years from the date of notification.

A non-resident exempt bondholder is required to appoint the QFI to hold the JGB's under power of attorney. The QFI must verify and retain the identification and appointment documents, notifying the Japanese custodian, which is the book entry system participant (JBESM), that they hold the documents.

Foreign Investment Trusts

Exemption is extended to include foreign investment trusts that are assimilated to Japanese securities investment trusts or public or corporate bond management investment trusts. The exemption is subject to the Foreign Investment Trust meeting the following conditions:

- Where the trust sells units only via a public offering either inside or outside of japan and distributes the profits through a paying agent in Japan; or

- Units of the trust are acquired as trust assets only by other qualified foreign securities investment trusts.

Other types of funds may also be eligible such as an entity treated as a partnership for US tax purposes as long as the fund is a foreign corporation for Japanese tax purposes. A partnership however, can apply for the exemption as it is obliged to provide details of all the partners in its application. However where the partnership is part of a master-feeder structure and cannot provide this information it is unlikely to be accepted as an exempt entity.

Question 6

The new regulations were implemented with effect from 1 January 2018, and subject investment funds (UCITS and AIF which aren't partnerships) to German corporate tax to the extent they generate income from German equities.

With the intent to prevent tax avoidance schemes, the taxable income includes income arising in connection with securities lending and repo transactions on German equities at the level of the investment fund, including:

- Manufactured dividends
- Lending fee
- Income from securities serving as collateral.

The income is only subject to taxation if the securities lending or repo transaction period included the dividend record date.

The law obliges a German borrower i.e. the entity that pays the lending income to the lender to withhold the tax due on the 'real' dividend i.e. the gross income received up to the limit of the original gross dividend. A non-German borrower is not obliged to withhold tax. A German branch of a non-German bank that is a borrower is obliged to withhold whereas a non-German branch of a German bank that is a borrower is not obliged to withhold.

The tax levied by the German borrower, is without regard to any reclaim options under an applicable DTT that the lender may have and without regard to any uncertainty regarding the fund qualifying under the regulations as being subject to withholding.

The regulations exclude central counterparties from the obligation to withhold, however they have a duty to notify the borrower of their obligation to withhold.

In the event that the borrower is non-German, the lender is obliged to notify the German tax authorities if income in accordance with the regulation has been received an either not tax has been withheld, the tax withheld is too low or the tax has been refunded by mistake.

Question 7

On 25 May 2018, the Economic and Financial Affairs Council (ECOFIN) formally adopted Council Directive (EU) 2018/822 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (commonly referred as "DAC6").

Under the directive, intermediaries based within the EU will be required to submit information on reportable cross-border arrangements to their local tax authorities.

An 'intermediary' refers to any person that designs, markets, organises, makes available for implementation or manages the implementation of a reportable cross-border arrangement.

It also includes any person that, having regard to the relevant facts and circumstances and based on available information and the relevant expertise and understanding required to provide such services, knows, or could be reasonably expected to know, that they have undertaken to provide aid, assistance or advice with respect to a reportable cross-border arrangement. Intermediaries will undoubtedly include lawyers, accountants, tax and financial advisors, banks and consultants.

Should the intermediary not be located in the EU or is bound by professional privilege or secrecy rules, the obligation to report shifts from the intermediary to the relevant taxpayer.

A 'reportable cross-border arrangement' is defined as any cross-border tax planning arrangement that's exhibits one or more of the hallmarks listed in the Directive and concerns at least one EU Member State.

The hallmarks cover a broad range of structures and transactions, including certain deductible payments that are taxed at a rate of zero or nearly zero when received.

It should be noted that certain arrangements, such as those that fall within the specific transfer pricing hallmark, will need to be reported even if they do not satisfy the "main benefit" of obtaining a tax advantage test. These include arrangements that involve hard-to-value intangibles or an intra-group cross-border transfer of functions, risks or assets.

Information with regard to reported arrangements will be automatically exchanged by the competent authority of each EU Member State every three months via the use of a secure central directory.

The information required in the actual disclosure will include the identification of the intermediaries and relevant taxpayers, their country of residence and tax identification (TIN). In addition, a summary of the arrangement itself will have to be included, which would include details on the relevant hallmarks and national provisions, details on the first step of implementation, and information on the value of the reportable cross-border arrangement. In addition, identification of Member States that are affected or likely to be concerned by the reportable arrangement would be included.

Non-compliance (by intermediaries or taxpayers) with reporting requirements attract penalties, but these penalties will be determined by the domestic legislation of the EU member state, so are likely to vary from state to state. The directive does state that the penalties must be "effective, proportionate and dissuasive". In addition, the Directive confirms that the fact that a tax authority does not react to a reportable cross-border arrangement does not imply any acceptance of the validity or tax treatment of that arrangement.

EU Member States shall adopt and publish national laws required to comply with the Directive by 31 December 2019 and apply the new rules from 1st July 2020.

It should be noted that the Directive and therefore the reporting obligation applies to transactions implemented as from 25 June 2018.

Information filed by intermediaries and relevant tax payers are required to file information for the first time by the 31st August 2020, this is with respect to reportable transactions implemented between 25th June 2018 and 1st July 2020 ("first reporting period"). Record keeping for any transactions that have occurred since 25th June 2018 is key. This information is to be exchanged between EU Member States by 31 October 2020.

The first "regular" information exchange between EU Member States will have to take place by 31 October 2020.

After this first reporting period, a reportable arrangement shall be reported within 30 days beginning on the day after the arrangement: was made available for implementation, or was made ready for implementation, or when the first step in the implementation was undertaken, whichever occurs first.

In addition, intermediaries who provided aid, assistance or advice are required to to file the information with the authorities within 30 days beginning on the day after they provided such aid, assistance or advice.

Question 8

In recent years there have been a number of significant tax cases regarding intra-group financing arrangements around cash pooling. The aim of cash pooling arrangements is generally to provide visibility over the group's liquidity, which in turn will minimise the cost of funding.

The ConocoPhillips Skandinavia AS and Norske ConocoPhillips AS v Ojeskattekontoret, (2010) case decided that arm's-length rates should be established on the foundation of true credit risk by each participant, with relative bargaining power determining profit allocation.

The ConocoPhillips cash pool was a Zero Target Balancing cash pool. In a zero-target balancing agreement, participant members who have a cash surplus transfer that surplus from their own bank account to the account of the cash pool leader. The cash pool leader will then transfer funds to any other participant in the group who is in deficit. The cash pool in the ConocoPhillips group contained 150 group members. Even though each of the participant members were jointly and severely liable, the parent company provided a guarantee that to the bank for the cash pool liabilities.

Within the group there were two Norwegian tax resident companies. These companies were always in credit, as a consequence their cash surpluses were moved to the cash pool leader. In addition, the cash pool was actively managed, with the purpose being to ensure that it, to, was always in credit. The bank paid the London Interbank Bid rate ("LIBID") less 25 basis points to all 150 member accounts, whether they were in credit or not.

However, the Norwegian tax authorities ("NTA") took the opinion that -25 basis points was an artificially low rate. The NTA argued that all participants in the pool received this rate, even though each of the participants had differing financial performance, and that the two Norwegian tax resident companies should in fact be getting a more favourable interest rate than poorer performing participants in the pool, something that they would have received had the transaction with the bank been at arm's length.

The two Norwegian participants were always in credit, which always assisted with the cash pool leader being in credit, and that this influenced the beneficial rate that all participants enjoyed. The NTA took the stance that this sequence of events gave the Norwegian companies excessive influence over the pool, and as a consequence a right to share in the co-ordination benefit more than other non-Norwegian tax resident participants, for example those who could end the day in cash deficit.

The NTA determined that the two Norwegian subsidiaries should in fact be receiving LIBID +25 bps in interest. The ConocoPhillips group argued in court that this was irrelevant, as cash pools do not happen between unrelated entities at arm's length from one another. The court agreed with the NTA, in doing so dismissing ConocoPhillips' arguments. The result was an upward adjustment of the Norwegian participants' incomes, and therefore an increased taxable income. What was the OECDs view regarding intra-group financing in BEPS Action points 8-10 had on intra-group financing.

BEPS has had an important effect on the taxation of cross-border financing. Actions 8 – 10 require that the attribution of value for tax purposes is consistent with the economic activity generating that value, and this applies to the transfer pricing of intra-group treasury and financing activities.

Indeed, BEPS specified the importance of synergistic benefits in this context. The OECD Transfer Pricing Guidelines for Multinational Enterprise and Tax Administrations, 2017 (OECD Guidelines) confirm that "synergistic benefits and burdens of group membership may arise because of deliberate concerted group actions and may give an MNE group a material, clearly identifiable, or structural advantage or disadvantage", and insofar as "important group synergies exist and can be attributed to deliberate concerted group actions, the benefits of such synergies should generally be shared by members of the group in proportion to their contribution".