MATHILDE OSTERTAG AND ARNE BOLCH
GSK Stockmann

Staying competitive under BEPS

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TAX PARTNER MATHILDE OSTERTAG AND INVESTMENT FUND PARTNER ARNE BOLCH OF LAW FIRM GSK STOCKMANN SAY THE FINANCIAL WORLD IN GENERAL AND THE FUND INDUSTRY IN PARTICULAR ARE HAVING TO COME TO TERMS WITH THE INDIRECT IMPACT OF BEPS IN AREAS SUCH AS SUBSTANCE AND INVESTMENT STRUCTURES. THEY ALSO URGE THE NEXT GOVERNMENT TO FOCUS ON THE COUNTRY'S (TAX) COMPETITIVENESS.

How is BEPS impacting your clients activities?

Mathilde Ostertag (MO): When the OECD launched its initiative on base erosion and profit shifting in 2012 to combat tax avoidance, many professionals did not take it very seriously. The BEPS Action Plan resulted in concrete measures such as the Country by Country reporting (CbCr), CRS and FATCA, the Multilateral Instrument (MLI), the Anti-Tax Avoidance Directives (ATAD), controlled foreign companies rules (CFC) and the enhanced cooperation between the tax administrations. Further to their implementation, clients are being impacted, especially to the extent that Luxembourg is used as a holding jurisdiction. Aside of the increasing tax compliance, a key element for clients will be enhancing their substance. First, it was offices and then headcount, but now professionals understand the increasing need for highly-qualified decision-makers to be located here. They also must pay attention to the way their business and transactions are documented. As a direct consequence of BEPS Action 6, the taxpayers will have to compile and document (non-tax) business reasons in their transactions, as to meet the Principle Purpose Test (the new treat anti abuse measure under the MLI) for all tax treaties as of the entry into force of the MLI.

Arne Bolch (AB): With the need for greater substance, funds' domicile has become a more important issue. Fund managers need to decide whether they should have their complete investment structure in Luxembourg or only the fund vehicles and to what extent major investment decisions may be taken there. While BEPS does not address funds directly, it has a significant impact on the structuring of the funds' investments.

What developments do you see in international investment strategies?

AB: As a real estate-driven firm that is a market leader in Germany, we are seeing a lot of new developments. Real estate funds with European strategies are coming to Luxembourg, and the German market remains strong. However, a shift is visible from top-tier (A) to second (B) - and third-tier (C) cities, as well as a transition from purely commercial investments to residential or specialist real estate investments such as nursing homes or student housing. In terms of venture capital investments, the European Commission's Juncker plan (ie the European Fund for Strategic Investments) has contributed to the financing of venture capital funds, but the asset class that has grown significantly, lately is loan funds. While Luxembourg SIFs could always issue loans, in former times home countries of the respective borrowers did not necessarily allow loans to be granted by anybody else but banks. Since the introduction of the AIFM Directive and driven by ESMA, many countries have now relaxed their rules and hence also investment funds are in principle allowed to act as lender in a growing number of EU countries. In an effort to achieve higher yields, insurance companies and pension funds have increasingly diversified into the asset class of loan funds.

MO: Private equity as asset class is still very active, the investment volume grows steadily. From an economical perspective however we understand from the market that the ticket deals are smaller for institutional investors: a decade ago you could heavily leverage an investment, whereas the IRR is now smaller. In real estate, the shifts reflect the large volume of liquidity available.

What should the next Luxembourg government focus on?

MO: As a tax specialist, I would encourage the new government to focus on investor-friendly tax reforms to maintain Luxembourg's competitiveness. While adhering to the BEPS rules, all countries are working hard on their tax regime to remain attractive. Several have reduced their standard corporate tax rate or taken other tax measures. The Netherlands is planning to abolish its dividend withholding tax, the UK has been reducing its corporate income tax rate for the past 5 years, and France is reducing its corporate income tax and withholding tax rates to 25% by 2022*. There is a risk that Luxembourg could be left behind compared to other EU countries.

AB: Luxembourg needs to be fully compliant but still maintain its competitiveness. The new government should remain a strong voice in Europe on the development of the regulatory framework of investment funds and it should actively contribute to any European initiatives adequately balancing the markets' attractiveness with investor protection.

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of the evolution of the corporate income tax rates in five European jurisdictions at:
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