

Economic Substance in the New Reality - Is your Holding Structure at Risk?

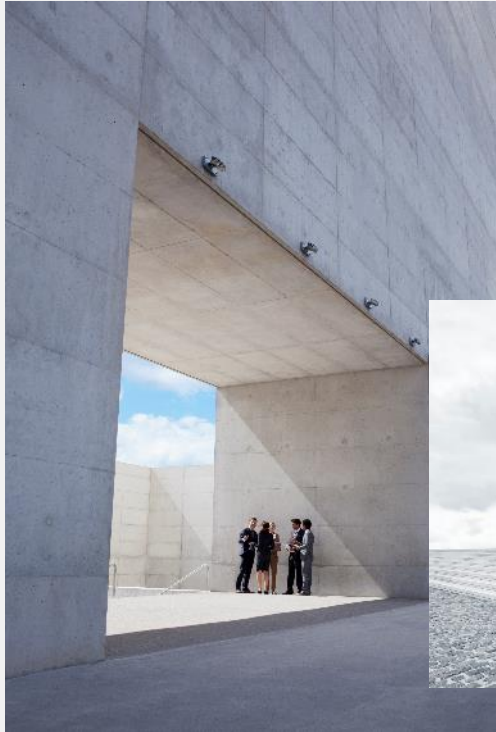
STEP Lausanne

13 September 2020

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Introduction

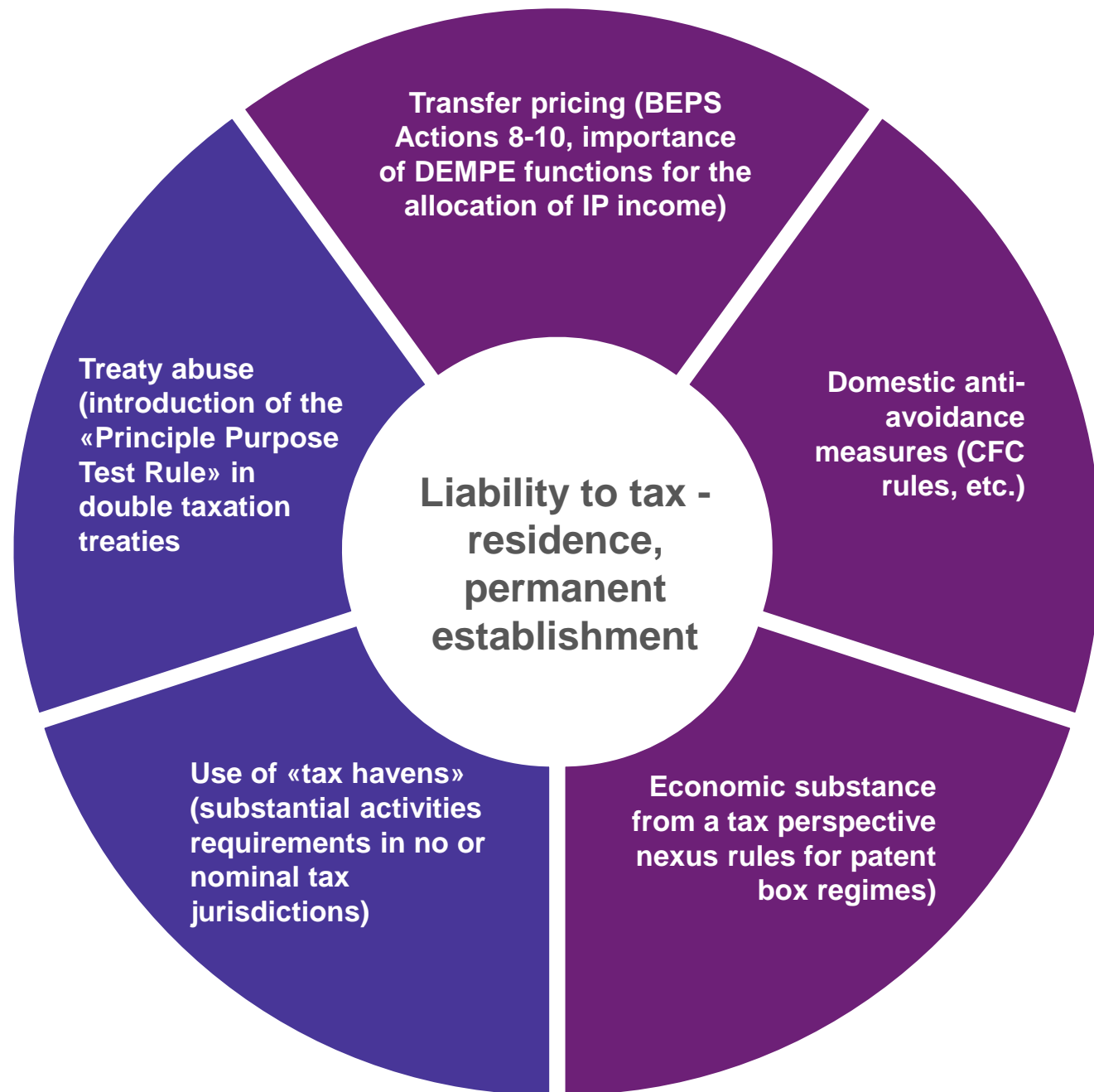


COVID-19 has led to travel restrictions, remote working, etc. This has long term implications on the way we work and live.

Tax issues:

- OECD recommendations 3 April 2020
- Guidelines issued by national tax authorities
- International agreements
- => Temporary measures

Economic substance from a tax perspective



Substantial activities requirements

Background

OECD 1998 Harmful Tax Competition Report =>

2015 BEPS Action 5 Final Report =>

Additional 2018 and 2019 Guidance on no or only nominal tax jurisdictions

EU 1997 Code of Conduct =>

EU Council conclusions of 8 November 2016 ("Fair taxation", section 2.2) =>

Lists of non-cooperative jurisdictions



Effects

Many no or nominal tax jurisdictions implemented rules requiring economic substance for resident companies and reporting requirements



Definition

Three general aspects to economic substance:

- Being directed and managed locally
- Conduct core income generating activities locally
- Having adequate people, premises and expenditures locally



Sanctions

Domestic reporting => dissuasive sanctions for failure to meet substance requirements



Process

In case of non-compliance, transfer of information to the State of residence of

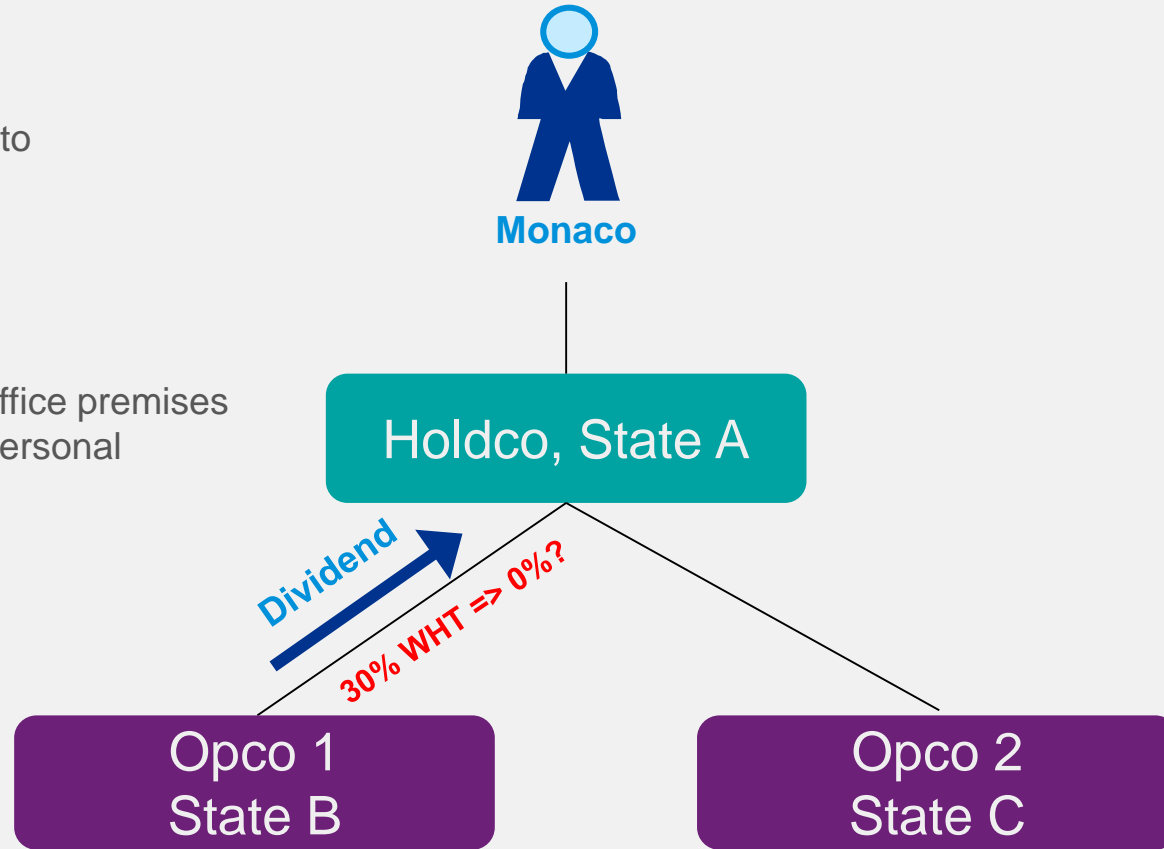
- 1) the immediate parent company,
- 2) 2) the ultimate parent company or UBO

Treaty abuse

— Holding companies often need to apply double taxation treaties

— Treaty shopping:

- No office premises
- No personal



Treaty abuse - the "PPT rule"



OECD Multilateral Instrument: the «Principal Purpose Test»

Multilateral Instrument signed by 67 jurisdictions on 7th June 2017, including Luxembourg (94 signatories as of 28 February 2020)

More than 1'680 Covered Tax Agreements

The PPT rule needs to be taken into consideration for the application of more than 300 double taxation conventions with regards to withholding taxes on dividends paid as from 1 January 2020



Art. 1(2) to (4) Parent-Subsidiary directive (Council Dir. 2011/96/EU)

As amended by Council Directive (EU) 2015/121 of 27 January 2015

Directly applicable as from 1st January 2016

Treaty abuse - New clause

Art. 7(1) MLI

*Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that **obtaining that benefit** was **one of the principal purposes** of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.*

Art. 1(2) to (4) PSD

- 2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.*
- 3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.*
- 4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.*

Treaty abuse - the "PPT rule"

"Why is the arrangement or transaction implemented or maintained the way it is?"

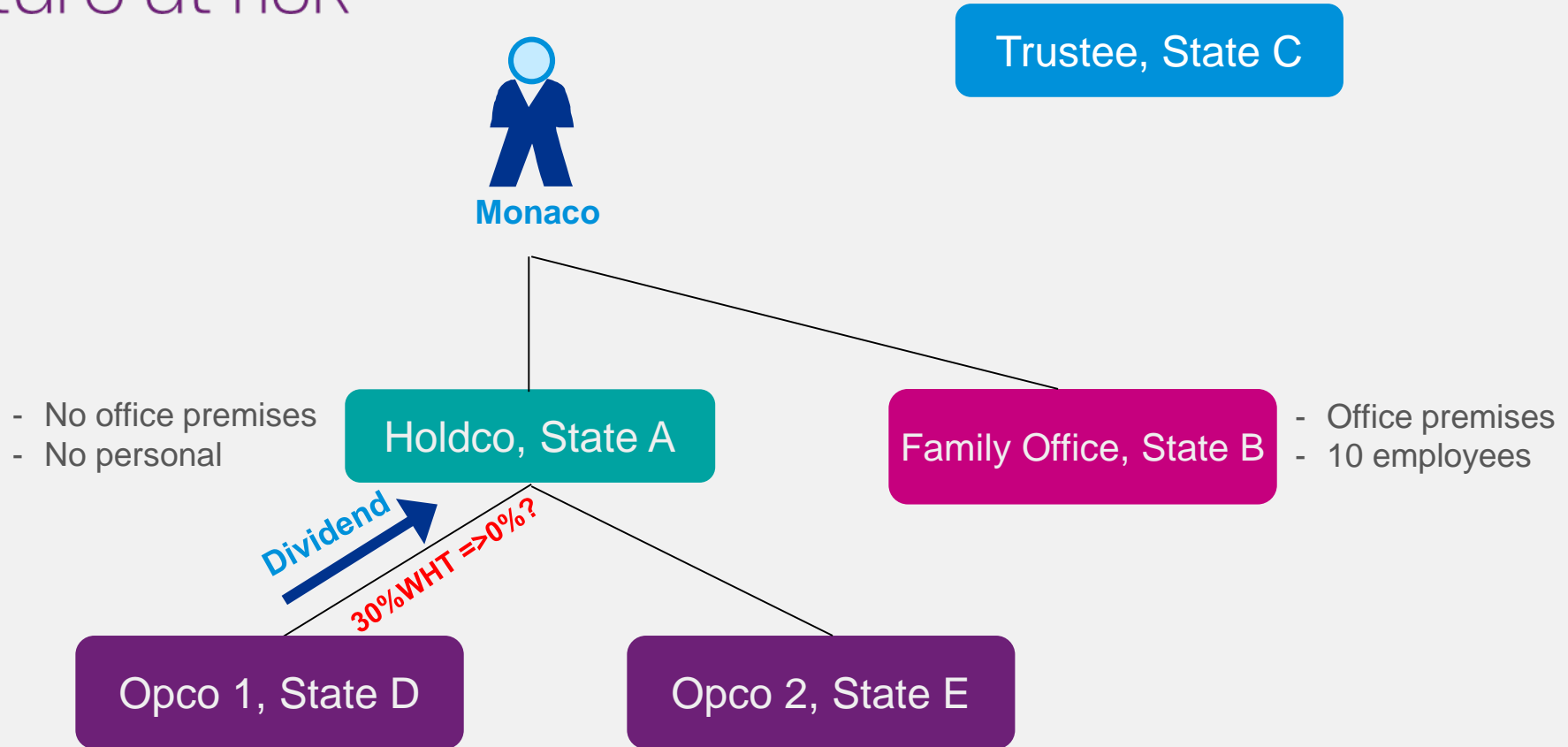
"... where an arrangement is inextricably linked to a core commercial activity and its form has not been driven by consideration of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit..." (OECD MC Commentary ad art. 29, para. 181)

Acceptable "principal purposes":

- Availability of qualified local human resources in view of the activity to be carried out by the entity => **SUBSTANCE**
- Cost of such resources => **SUBSTANCE**
- Coherence with existing business model
- Investment protection (network of bilateral investment treaties)
- Etc.

☞ Benefiting from the State of residence's treaty network shall not be a main purpose...

Structure at risk





Going forward

- Substance requirements need to be considered post confinement
 - => Will impact the way we design ownership and family office structures
- Reduced incentive to set up or maintain offshore structures
- Align substance and legal structures => favour:
 - Simple structures
 - Concentration of substance in a limited number of (onshore) jurisdictions
- Additional reporting requirements for clients with regards to entities in no or nominal tax jurisdictions

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