THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

SAMPLE SOLUTIONS

MODULE 3.05 – BANKING OPTION

ADVANCED INTERNATIONAL TAXATION (THEMATIC)

PART A

Question 1

Part 1

Considering the applicability of FFTT to a CDI issued on the ASX

FFTT is liable when there is a transfer of ownership for consideration of shares or equivalent securities admitted to a regulated market an issued by a French company with a market capitalisation of more than 1BN euros.

The transfer of ownership is effective on the settlement date of the trade.

Under the regulations a security includes an equity security or its equivalent. Equity securities include shares and other securities that give rise or could give access to capital or voting rights. If an instrument is issued under foreign law and is equivalent to an equity security, FFTT will be applied.

Depositary Receipts (GDR and ADR) in respect of French shares come within the scope of FFTT, given the applicability of FFTT to GDR / ADR, it is likely that FFTT will be applicable to an ASX listed Chess Depositary Instrument relating to a stapled French and Australian share.

The CDI Stapled Instrument is issued on the Australian Stock Exchange, this is an AMF recognised foreign market, however it should be noted that if all other conditions are met the FFTT would be applicable if the trade was completed OTC or in a Multilateral trading facility.

The condition requiring a market capitalisation in excess of Ibn is based on the market capitalisation as at 1 December prior to the tax year. However in this instance due to the reorganisation arising through the merger of Mercury and Unicorn the applicable value date has been determined based on the respective shareholders equity as 31 December of the year preceding the date of the acquisition.

The FFTT is assessed and paid by the Investment Service Provider (ISP) that executes the buy-order, the statutory taxpayer, rather than the acquirer of the security with the ownership rights, the economic payer. Where there is a chain of ISPs the tax shall be assessed and paid by the firm that received the purchase order directly form the end buyer.

Based on the above, MercuryUnion CDIs fall within the scope of FFTT with an applicable FFTT rate calculated based on the Mercury proportion of the acquisition price at the applicable FX rate.

Part 2

Calculation of applicable FFTT rate

		In Base	**Exchange Rate**	**In Euros**
Mercury	French entity Shareholder Equity	11	1	11
Unicorn	Australia entity Shareholder Equity	19.85	1.571	12.6352642
			Ratio	**0.87057935**

The applicable FFTT rate utilising the above is:

0.30% x 0.870579345 = 0.26117%

The tax is applied on a transfer of ownership, the French Monetary & financial code stipulates that the transfer is the result of the posting of the securities to the account of the buyer, i.e. the effective settlement date.

The general tax code provides that for the given period the net long position is calculated for a given acquirer excluding any exempt transactions, this is multiplied by the average unit price for non-exempt purchases of the security.

Given the transactions for CDI are carried out on ASX is a non Euro stock market the taxable value is based on closing price of the currency market of the currency in question on the day before the acquisition.

There are a number of exemptions excluded form liability and also excluded in the calculation of the FFTT, the nine exemptions applicable are:

1. Primary market transactions

2. Transactions by clearing houses and central depositaries

3. Market-making transactions

    a. Simultaneous quoting of firm bid /ask prices, of comparable size to ensure market liquidity on a regular and continuous basis
    b. In the course of normal business when executing orders given by clients or in response to buy and sell requests
    c. Hedge positions relating to transactions in (a) or (b)

4. Transactions under liquidity contracts

5. Intra-group and restructuring transactions

6. Securities financing transactions

7-8. Employee savings scheme transactions

9. Transactions in Bonds that can be exchanged or converted for shares

The FFTT rate of 0.30%, or the as adjusted amount shown earlier is applied to the execution price of the in-scope security transaction excluding transaction fees, such as brokerage and settlement fees.

<u>Calculation of the FFTT due given the facts and circumstances</u>

From the information provided FFTT is applicable to the transactions as follows:

ID #	**Settlement Date**	**3rd Party**	**Trade Information**	**Assessment**
1	17 Aug	3rd Party - Australian Bank no. 1	3rd Party cross the futures on market, EA cross the stock on market. 3rd Party is an ISP	The is a prop acquisition by EA as such EA is liable for FFTT
2	22 Aug	Big US Bank no.1	3rd Party buy for their own account, not adhered to AFME protocol, bi-lateral agreement in-place confirming not ISP	The 3rd party is buying but is not an ISP, so the FFTT obligation falls on EA, the net of trade 2 and 4 at the weighted average Strike Price is the Taxable Base

ID #	Settlement Date	3rd Party	Trade Information	Assessment
3	22 Aug	Big US Bank no.2	Give-up trade to 3rd Party Broker (ISP), trade settled in name of end client (not ISP)	The give-up trade is booked to an end client who is not an ISP, EA must apply the FFTT as the statutory tax payer (the end client is the economic taxpayer)
4	22 Aug	Big US Bank no.1	3rd Party sell, not adhered to AFME protocol, bi-lateral agreement in-place confirming not ISP	See 2. above
5	27 Aug	Exemplar German Branch (wholly owned by EL)	German affiliate, adhered to AFME protocol, wholly owned by EL, German Affiliate acting as Broker to client who is not an ISP	This is a trade with an affiliate entity wholly owned by the parent company EL. Therefore EA does not apply FFTT
6	30 Aug	Australian Counterparty	Counterparty is an ISP, EA acquiring to fulfil a counterparty order for 150,000	150k of acquired shares are to fulfil a client order so fall within Market-making exemption 3b. The remaining 25k would fall in-scope of FFTT but the counterparty is an ISP therefore they will apply and pay the tax.
7	1 Sept	French SE	3rd Party trading on their own account adhered to AFME protocols	This trade settled in September, therefore does not fall within the August FFTT calculation.

The applicable FFTT calculated on the above basis is:

Calculation of FFTT

Trade No.	Sett. Date	No Shares	Price	Weighted Ave price	Settlement Value	FFTT Rate	Tax Due	FX Rate	Amount due
1	17-Aug	500,000	10.120	N/A	5,060,000.000	0.26117%	13215.39	1.6025	8246.74
2	22-Aug	250,000	10.210	10.199					
4	22-Aug	185,000	10.185	10.199					
		65,000		10.199	662,935.000	0.26117%	1731.41	1.6130	1073.41
3	22-Aug	400,000	10.175		4,070,000.000	0.26117%	10629.77	1.6130	6590.06
5	27-Aug	250,000	10.550	N/A	N/A	N/A	N/A	-	
6	30-Aug	25,000	10.850	N/A	N/a	N/A	N/A		
							Total		15910.21

Given the Central Depositary is established outside France, EA must provide return SD-3374 to the Large Corporations Division of the French Tax Authority by the 25th of the month following the month of settlement of the securities and must make by the same date.

Given the CDI is registered on the ASX there is no requirement for a monthly statement to be submitted.
Although the SD-3374 only requires amounts payable to be provided and there is no obligation to submit a monthly statement, EA must maintain a record of the transactions and support for the application of any exemptions.

Question 2

Part 1

Analysis should be undertaken to consider if there is a benefit to the recipient of the guarantee Mega FS. With the guarantee in place that Mega FS has been advised that their bonds will have a superior credit rating AA versus current credit rating of BB of Mega FS. Therefore, reasonable to conclude that was a benefit and cost of finance will be reduced with the guarantee in place, i.e. the rate of interest that Mega FS. will be required to pay will be reduced.

Now established benefit need to construct an arm's length guarantee fee. Methodologies to consider:-

Comparable uncontrolled price method (CUP)

- Do internal comparable exist? e.g. Does borrower Mega FS. Have other comparable loans which are guaranteed?
- Do external comparable exist? e.g. Independent guarantors providing guarantees for loans that are comparable.
- Consider factors which affect guarantee fee: Risk profile of Mega FS, terms of the guarantee-implicit or explicit? Terms and conditions of the loan, what are the current market conditions in loan markets.

Capital support method

- Appropriate where the variance between the guarantor and borrower's level of risk could be could be solved by an injection of capital into the borrower's balance sheet. Unclear if it could be in this example. Possible as have the credit rating of the borrower without the guarantee (BB).
- Then establish how much additional capital is required in order to bring Mega FS up to AA credit rating.
- Guarantee could then be calculated based on an expected return on this amount of capital.

Valuation of expected loss approach

- Method could be employed to estimate the value of a guarantee based on the probability of default, and then adjust on the basis of what would be the anticipated amount of recovery in default.
- Apply this recoverable amount to a nominal amount guaranteed result to derive the cost of providing the guarantee.
- Price guarantee based on expected return on this amount of capital using model such as the capital asset pricing model.

Cost approach

- Aim here is to calculate the extra risk borne by the guarantor by estimating the value of the expected loss that the guarantor incurs by providing the guarantee.
- Models that can be used for estimating expected loss and capital requirement work on the basis that the guarantee given by Mega BH. Is equivalent to another financial instrument- for example a credit default swap (CDS), or using option pricing models with the guarantee as a put option.

Yield approach

- Aims to establish the interest rate differential benefit that Mega FS. Receives from the guarantee.

- Firstly determine interest rate that would have been payable by Mega FS in the absence of any guarantee. You may take into the consideration the implicit support from being part of the Mega group.

- Secondly calculate the interest rate payable by Mega FS had it had the same credit rating as Mega BH.

- Benefit to be priced is the difference between cost to the borrower after taking into account the benefit of any implicit support and the cost with the benefit of the explicit guarantee.

Part 2

Cash pooling is used to manage the group's cash position on a consolidated basis, effectively concentrating the group's cash in one place. Cash pooling arrangements deliver visibility over a group's liquidity and reduce the costs of funding and hedging. There are 2 notable forms of cash pooling, Physical sweeping of cash, or Notionally offsetting with no physical movement of cash. Organisation can of course use a combination of physical and notional pooling.

In response to the concerns over base erosion, tax authorities are looking at and clarifying their approach with respect to cash pooling arrangements. The OECD in BEPS 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 as well as trading transactions.

OECD focus area is the allocation of benefit. Necessary to determine (i) the nature of the advantage or disadvantage, (ii) the amount of the benefit or detriment provided, and (iii) how that benefit or detriment should be divided among members of the Mega group. The Mega group need to consider the functions, assets and risks of the group parties and the benefit should be allocated based on this.

With regard to risk, the Mega group needs to consider economically significant risk. Who in the Mega group controls risks such as the currency exposure? Can the group entity economically bear this risk?
Consider rate of interest. Is this rate comparable with what the borrower would obtain from a third party, such as cash deposit in a bank or by investing in US treasury bills? In recent guidance released by HMRC in the United Kingdom, HMRC acknowledge that there unlikely to be a comparable uncontrolled price that you can use to assess how interest rates would have been set among independent third parties for the cash pooling arrangement *as a whole.*

Rewarding the cash pool member- OECD in Discussion Draft, which has been published as follow up work in relation to Base Erosion and Profit Shifting (BEPS) Actions 8-10 suggest three approaches can be envisaged for allocating the cash pooling benefits to the participating cash pool members.

- Enhancing the interest rate for all participants-appropriate where both debit and credit balances in the pool, to benefit both borrowers and lenders with a larger interest rate if they contribute a larger balance to the pool.

- Applying the same interest rate for all participants-appropriate where all cash pool members have same or similar credit profile, regardless if they are creditors or depositors in the pool.

- Credit rating of Mega Pool is unknown but if is below the depositors OECD acknowledge that can allocate the cash pooling benefits to the depositors-appropriate where credit risk to the depositors on the basis they have their capital at risk.

Another key consideration in analysing cash pooling are situations where group members maintain surpluses or borrowing positions which, rather than functioning as part of a short-term liquidity arrangement, become more long term. If become long term do we need reclassify the cash balance as a short term deposit or even a loan? How should the balances, which may fluctuate daily be priced?

As part of the cash pooling arrangement, cross-guarantees and rights of set-off between participants in the cash pool may be required. This raises the question of whether guarantee fees should be payable.
Most countries have domestic legislation in place that requires organisations to document the arms length nature of intragroup transactions, cash pooling arrangements must therefore be correctly documented and available for tax authority upon request.

Part 3

Regarding the Portuguese Arbitration Tax Court decision, (2012), the key findings were:

- The possible existence of an implicit intragroup guarantee, through the notional cash pooling mechanism, which should be remunerated on an arm's length basis.

- Upon selection of the CUP method, the choice of the internal or external comparable, is extremely complex. In what concerns the application of the CUP method, suggested by the PTA, in order to achieve the arm's length remuneration associated with the financial transaction, it was accepted by the Arbitration Court. However the comparables put forward by the PTA were challenged on the basis that they did not provide "*the highest degree of comparability focusing in the object... and in the functional analysis of the entities involved* ", thus violating "*the regulation that define the CUP method"* selection as the best method to use.

- The adequate analysis of the most appropriate transfer pricing method to use on the notional cash pooling operations **-** profit split method could be the most favourable alternative, if duly supported.

PART B

Question 3

Part 1

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.

An ‘agent’ is defined by UK law and includes anyone with authority to enter into contracts on behalf of the entity.

Part 2

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

Nevertheless, recognising that different countries approach the criminalisation of taxpayer non-compliance differently, an offence will only be committed where it meets a requirement of dual criminality.

Firstly, the offence is a criminal offence in the country where it is committed (s.46(5)(a)), and also the offense would be considered as the fraudulent evasion of tax in the UK (s.46(5)(c)).

Secondly the facilitation offence must be a criminal offence in the jurisdiction where 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 3

UK companies- UK parent and UK subsidiary are incorporated under UK law, and meet the definition of UK based relevant bodies. Result-they are in scope for the foreign tax corporate offence.

Overseas subsidiary- Assuming that the subsidiary does not act as an associated person to the UK entities, the overseas French subsidiary is not UK relevant body as it is not incorporated under UK law or conduct business in the UK. The French subsidiary would be in scope for the corporate offence related to foreign tax if an associated person undertakes an act of criminal facilitation in the UK.

Overseas PE- same legal entity as UK Incorporated Head office. As a result the overseas PE is in scope for the corporate offence related to UK tax and the foreign tax corporate offence.

Part 4

HMRC has identified six key principles (the ‘principles’) that organisations wishing to prevent the criminal facilitation of tax evasion by associated persons should consider when establishing reasonable prevention procedures.

Risk assessment

The risk of tax evasion facilitation should be clearly articulated, and the risk assessment should be documented. For example, who are the associated persons? Identify internal (employees) and externally (agents, representatives, contractors). Do they have opportunity or incentive to facilitate tax evasion? For example, do they provide they provide tax advice to AtoZ clients?

In addition, the risk assessment should include consideration of the following risks, assessing which areas are high, medium or low risks and ensuring that sufficient controls are in place to manage them.

- Country risk. What's the global footprint of the business- interaction with high risk countries that have unlikely to subscribe to the Common Reporting Standard and be given a low tax transparency score by the OECD.

- Sectoral risk. HMRC guidance states that organisations offering private wealth management services are particularly identified as facing significant risks.

- Business partnership risk.

- Business opportunity risk. How will these products be developed in the future?

- Transaction risk. What tax planning structures is the company operating?

- Product risk. Do the companies wealth management products lend themselves to the facilitation of tax evasion?

- Customer risk. Have tax onboarding procedures been documented e.g. FATCA/ CRS

To assist firms in identifying risk, HMRC suggest consulting the Financial Conduct Authority's ("FCA") guide for firms on preventing financial crime, the Joint Money Laundering Steering Group's ("JMLSG") and the Ministry of Justice's Bribery Act guidance – considering them from a tax fraud perspective.

Top level commitment

HMRCs guidance recommends senior management are involved in the communication and endorsement of the firm's policy on prevention of criminal facilitation of tax evasion. For example:

- A formal policy statement regarding zero tolerance towards the criminal facilitation of tax evasion.

- A summary of the consequences if associated persons contravene the organisation's policy.

- Link to risk assessment process-senior managers at AtoZ involved in risk assessment process, design and implementation of policies and procedures. If senior management not involved in day to day management of this, at demonstrate oversight of the process, e.g. by way of a governance committee.

- Formally approving the procedures once developed.

Proportionate policies and procedures

Once AtoZ have completed the risk assessment, need to document procedures to deal with those risk need to be put in place. To be "reasonable", prevention procedures must be proportionate to the risks that AtoZ faces.

The tax manager at AtoZ should consider a written policy, setting out (based on HMRCs risk factors):

- What controls the business has in place to deal with the risks (e.g. additional sign off requirements where higher risk activities are identified, contractual requirements imposed on contractors, etc.).

- Is the work of associated persons monitored?
- What are AtoZ's high risk products that could be used to criminally facilitate tax evasion?
- How will compliance with the procedures be enforced?

Due diligence

HMRC guidance identifies that financial services will already carry out due diligence procedures in relation to its customers, jurisdictions and transactions but that the application of existing due diligence procedures is not automatically adequate for addressing the risk of tax evasion facilitation.

Nevertheless procedures should be proportionate to the risk, and the tax manager needs to revisit the risk assessment. In some cases, maybe necessary to AtoZ to operate specific due diligence procedures to address the risk of facilitation of tax evasion and or have varying procedures for different parts of its business according to risk exposure, including enhanced due diligence for high risk services in the wealth management industry such as client tax advice.

It is recommended that AtoZ review their procedures to assess their suitability, adjusting where necessary and confirming that they are subject to regular review.

Training

Big area of focus for AtoZ given only the tax manager is aware of the legislation. Training in this area should be considered for:

- Senior management as to the risks of corporate criminal liability.
- The legal, compliance and tax teams as to the scope and content of the legal regime.
- Operational and client facing staff on the business's procedures, how to avoid triggering the offences and also the whistle blowing policy.
- External associated persons, if such training is considered proportionate to the risks posed.

Monitoring and review

- Consider who undertakes the review? E.g. Internal or external party.
- Make reviews periodic and document what has been reviewed, but necessary to change this cycle if there is a significant change in operations.
- Obtain feedback from staff on the changes to processes implemented by AtoZ.
- Link to other areas of the organization e.g. internal audit cycles.

Question 4

Part 1

Considering the Swiss 2015 Swiss Supreme Court Judgement

The facts and circumstances of the Supreme Court judgement in the Swiss 'Swaps Case' were:

- A Danish bank sold total return swaps (TRS) based on Swiss equities to known clients in Germany, the United Kingdom, the United States of America, the Netherlands and France. The TRS were structured in a way that the bank had to pay the whole (positive) share price performance and dividend income to the counterparty on the maturity date. In return, the bank received from the counterparty a variable interest payment based on LIBOR plus a fixed margin.

- The Swiss Supreme Court judgement denied the Danish bank claim for refund of withholding taxes following a concept of economic interdependence rather than consideration of abuse through an assessment of beneficial ownership. The courts focus on this broader economic interpretation considered the right of dividend disposition as relevant and separate from the beneficial ownership of the shares. Following a substance-over-form concept it concluded that the Danish Bank was not the beneficial owner of the dividends as there was at least a de facto obligation to pass on the dividends to the swap counterparties.

The Supreme Court considered economic interdependence in two ways:

1) Obtaining of income depends on the obligation to pass on the income, and
2) The obligation to pass on the income depends on this income being obtained.

Applying this concept the Supreme Court determined that an interdependence between the receipt of the dividends and the passing on of the dividends existed because:

- The interest and margin payments did not only allow the purchase of the shares as a hedge, but also permitted the receipt of the dividends;

- The distribution of risks under the swaps meant that the dividend amounts passed on to the swap counterparties always correspond with the actual dividends received by the Danish Bank even if there was no dividend payment at all;

- The purchase of the shares was concluded systematically before the dividend due date with the purpose of passing on the dividend as a manufactured dividend to the swap counterparties free of Swiss dividend withholding tax.

Comparing this with the current 2017 OECD Model DTA Commentary which was amended in 2014, Article 10 shows consistency in that, 'where the recipient's right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person they are not the beneficial owner. …This obligation will normally derive from the relevant legal documents but they can be found to exist on the basis of facts and circumstances', arguably this acknowledges that a de facto obligation is sufficient to limit the beneficial ownership under such circumstances.

Part 2

The judgement applied to the current facts and circumstances

Applying the Swiss Swaps case concept of interdependence to the facts and circumstances in this case gives the following analysis:

The Swiss Swaps Case ignores any abuse aspects of beneficial ownership concentrating on interdependence in a wider sense seeking a substance-over-form analysis of the facts and circumstances to determine if there is a de facto obligation to transfer the dividend received on the hedge to the counterparties due to economic interdependence arising from risk transference.
Considering the facts and circumstances in this case it can be seen that there is an incomplete risk transference to the Counterparties:

1) Contrary to the Swiss Swaps Case, Bank A did not receive funding through interest and margin payments to acquire the shares, therefore there is a commercial risk embedded in the transaction that the fees for the transaction are insufficient to offset an unexpected adverse cost of funds for the shares acquired;

2) The facts provided are silent on the treatment of an adverse movement in the share price, if this was not compensated there is an equity price risk embedded;

3) We can assume that the dividend amounts passed on to the swap counterparties always correspond with the actual dividends received by the Danish Bank even if there was no dividend payment at all;

From the above, it is clear that Bank A retains a residual risk and arguably the judgement in the Swiss Swaps case does not apply.

If the Swiss Swaps Case is found to apply the counter parties will be deemed the beneficial owners. Given the level of uncertainty it would be prudent for Bank A to limit manufactured dividend payments to 65% of the gross dividend i.e. apply the 35% Swiss withholding tax.

It should be noted that even if the Swiss Swaps Case is found to apply and the counter parties are deemed the beneficial owners, it is unclear if the Swiss Tax Authority would support a tax reclaim on their part as they could not evidence receipt of withholding tax directly suffered.

<u>Part 3</u>

<u>The implications for Bank A of the application of the Principle Purpose Test</u>

Switzerland in signing the MLI, did not make an article in election 7, thereby defaulting to the application of the Principle Purpose Test for Covered Tax Agreement. The PPT in outline provides that tax treaty relief will not be granted if it is reasonable to conclude that obtaining the benefit was one of the principal purposes of any arrangement or transaction. This test acts in addition to the Swiss Supreme Court judgement, and is unlikely to change or challenge the validity of the judgement.

Given the facts and circumstances in this transaction, there is a risk that, through the application of PPT, treaty relief would not be granted. This provides the Swiss Federal Tax Administration two different approaches to attack any tax reclaim made by Bank A.

To minimise the risk of the application of PPT, Bank A should document the commercial grounds for the transaction, demonstrating that the application of treaty relief is not the principal purpose.

PART C

Question 5

The OECD's *"The conditions for establishment of subsidiaries and branches in the provision of banking services by non resident financial institutions" (2017)* report suggests a number of observations with regards to the conditions of establishment of subsidiaries and branches by non-resident banks, in light of regulatory reforms undertaken since the financial crisis.

The OECD recognised that a significant number of jurisdictions adopted measures that affect branches of non-resident banking institutions as compared with subsidiaries of non-resident banking institutions, particularly after the global financial crisis of 2008. However, the margin of difference is not big in overall terms as far as individual reform categories are concerned.

Regarding specific countries the OECD highlighted that:

- Some countries do not permit establishment of branches by non-resident banks (Brazil, Mexico, and Russia) or only after incorporation (e.g. South Africa).

- Others countries do not allow branches of non-resident banks to operate in some banking services, mostly relevant to retail banking and/or deposit taking.

- With regard to the possibility of requiring a non-resident bank to establish a subsidiary (or financial holding company) instead of a branch, in the majority of cases the supervisory authority has the discretion to require this on a case-by-case basis, typically when certain conditions have been met.

It should be noted that since the financial crisis in September 2008 the OECD found that there has been some tightening about the conditions for non-resident banks to branch. An example of this is when the scale of deposit taking is substantial, certain jurisdictions will attempt to steer non-resident banks towards the establishment of a subsidiary:

- Indeed Australia and Hong Kong, China all require that material or significant deposit taking requires the establishment of a subsidiary. Indeed, the Hong Kong regulator can require that a local holding company be formed in order to hold the shares of an existing or proposed authorised institution.

- In South Africa, the parent undertaking's assets must be at least USD 1 billion to establish a branch.

- The UK's approach to branches of non-resident institutions is based on an assessment of the equivalence of the home state supervisor's supervision of the whole firm, the branch's UK activities and the level of assurance the Prudential Regulatory Authority (PRA) gains from the HSS over resolution.

- In the EU, a branch can be deemed "significant" depending on the market share or systemic liquidity and payment and settlement implications of the branch, and be subject to closer surveillance and disclosure.

A key issue that is being progressively monitored concerns liquidity requirements, some of which have been introduced since the crisis. There are exceptions to such requirements in the EU, such as among EU countries, and when the banking regulatory regime of a country is considered equivalent to the EU's CRR/ARDC4. Australia applies liquidity requirements on branches.

Financial requirements on branches has been discussed above, the OECD study also focused on the governance of branches, although they noted that overall since the 2008 financial crisis most jurisdictions that have branches of non-resident banks have increased their governance process. The OECD highlighted that some countries have implemented:

- ‘Fit and proper tests’ are the most common, with all countries that have governance requirements on branches apply a fit and proper test.

- Some countries required a risk management and/or audit function in the branch.

- 50% of the countries in the study require the establishment of a board of directors/management board.

Despite branching being a widely available option, due to the financial and governance requirements that are now being imposed, while the same or equivalent to domestic banks, may limit the attractiveness of branching going forward. In retail banking the OECD reported that that

a number of countries have applied certain safeguards to ensure the safety of depositors or to prevent deposit insurance from being activated for a branch.

With regard to regulation and subsidiaries, the OECD study also found that equivalent treatment of subsidiaries was standard practice. This signifies the importance of the concept as a basis for cross-border banking and its regulation.

Question 6

Introduced in 2011, the Bank Levy is a tax on the global balance sheets of UK and foreign banks whose total liabilities exceed £20 billion. Estimated that 30 banks are subject to the levy. The levy is a tax on the size of the balance sheet. Therefore, unlike corporate income taxes, even if the bank does not make a profit a levy will be due. However, most banks have effectively shrunk their balance sheets and returned to profit, there are now less liabilities and more profits to tax.

The budget in July 2015 made two changes. Firstly, the Bank levy rate decreased to 0.18% in January 2016 and will decrease every year until 2021 when the rate will reduce to 0.1% (rate for calendar year 2018 is 0.16%). 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. Banks are under pressure to raise capital levels and boost lending; increasing tax revenue should make both of those goals harder to achieve.

There had been concern that the levy was hurting UK competitiveness with reports in the media that at least one large banks were planning on moving its head office away from the UK. With the chancellor implementing the surcharge so the tax burden has been shifted away from balance sheets, to profits, which would make it easier forecast their expected tax liability.

The OBR has forecast that the new surcharge will raise £6.5bn between 2016/17 and 2020/21. However, the corporation tax surcharge would also have an impact on building societies which, like challenger banks, cannot be considered to pose a systemic risk to the UK economy.

Since the global financial crisis many challenger banks have appeared in the UK. Challenger banks are effectively exempt from the Bank Levy because their liabilities do not exceed £20 billion.

These new banks which aim to compete with large, long established banks. Challenger banks have raised concerns that the corporation tax surcharge could threaten their ability to secure investment to grow and block new challenger banks from entering the market.

From 2021 the Bank Levy will only apply to the UK balance sheets of banks, moving away from applying the levy to global balance sheets. By announcing that the Bank Levy from 2020/21 will only apply to UK balance sheets the Chancellor signalled that the objective of the Levy is shifting from being a corrective mechanism, towards more fully becoming a source of revenue. It should however be noted that overall size of the big bank’s global liabilities that provide risk to the UK economy, so should the policy objective of ‘*a fair contribution in respect of the potential risks they pose to the UK system and the wider economy’* now be revised?

Five years after the regime double taxation relief has now been addressed in the Bank Levy (Double Taxation Relief) (Single Resolution Fund Levy) Regulations 2016. These Regulations have effect in relation to periods of account ending on or after 1 January 2016.

The joint effect of the reductions to the rate of the Bank Levy and the introduction of the surcharge is likely to be positive for many large institutions. There will, however, be a number of companies who will be negatively affected. These include companies that will be subject to the surcharge that are not currently subject to the Bank Levy (due to their size or the definition of affected entities).

Additionally, in the short-term, the incremental tax burden on banks from the surcharge is predicted to exceed the amount of lost revenue from changes to the Bank Levy by around £2 billion (over the next five years) (source OBR). The shift away from taxing balance sheets to taxing profits is more reasonable and should make it easier for banks to forecast tax cost. However, it should be noted that this change will not occur until after the next general election, it remains to be seen whether a new Government would implement it.

Question 7

German Bank with Japanese Branch

Mike,

Thank you for your email, the change of stance by the Canadian Bank to include US equities within the scope of the SLB, alters both parties' obligations quite substantially.

An SLB involving the transfer of US equities and the subsequent payment of manufactured dividends between parties introduces 871m obligations under which manufactured dividend paid or received will be deemed US sourced and may be subject to Chapter 3 Non Resident Alien Withholding at the applicable treaty rate depending upon the declared status of the Canadian Bank.

When Japanese Branch lends US Equities to Canadian Bank:

As the Japanese entity is a QDD and a Branch of the German Bank which is a QI, and given that this is an 871m qualifying security, the Japanese Branch should provide a W-8IMY where the identified entity on Line 1 of the Certificate is the German entity. The W-8IMY should show the entity Chapter 3 classification as QI, however Part II of the Certificate should not be completed as the Japanese Branch is a QDD. Part III should be completed, selecting box 14 confirming the German Bank is a QI box 16 should be selected, confirming this Certificate relates to a QDD, although completing question 16b in its capacity as a German entity (rather than in its capacity as a Japanese Branch). Additionally the Japanese Branch must provide a separate Withholding Statement confirming the Branch is a Reporting Model 2 FFI, providing it's GIIN and address, city and country.

This documentation will ensure that the Japanese Branch receives manufactured dividends relating to US equities gross of any Chapter 3 Non Resident Alien (NRA) Withholding Tax. As a QDD and a primary withholder the Japanese Branch will be required to withhold on the manufactured dividend received based on the German / US Double Tax Treaty rate and pay this across to the IRS.

The Japanese Branch will receive a 1042-S from the Canadian Bank showing the gross income but no withholding, which it will use to support its submission of a 1042-S relating to the Stock Borrowing income on US equities it received and the primary withholding undertaken. As it is a QDD, the reporting obligation vests with the Japanese Branch rather than the German Bank.

When Canadian Bank lends US Equities to the Japanese Branch:

The German Bank through the Japanese Branch will pay manufactured dividends to the Canadian Branch, which are 871m qualifying and therefore will be subject to Non Resident Alien Withholding tax under Chapter 3 at the applicable rate in accordance with the Double Tax Treaty between Canada and the US.

To ensure The German Bank is withholding at the applicable rate the Japanese Branch should seek a Withholding Certificate from the Canadian Bank.

If the Canadian Bank provides a W-8Ben-E the German Bank will pay manufactured dividends net of NRA Chapter 3 Withholding Tax in accordance with the applicable withholding rate specified in Part III of the W-8Ben-E, the Claim of Tax Treaty Benefits section. If the Canadian Bank provides alternate documentation such as a W-8ECI or a W-9 there will be no withholding obligation under Chapter 3, but there will be alternative reporting obligations.

If the Canadian Bank provides a W-8IMY specifying that the entity is a QI under Chapter 3 and in Part III confirms it is a QDD, the entity is in effect taking on responsibility for primary withholding which will mean the German Bank should make all manufactured dividend payments gross i.e. with no withholding under Chapter 3.

In both instances above (W-8Ben-E & W-8IMY / QDD) the German Bank will have an obligation to report the amounts paid and any applicable withholding on a 1042-S to the IRS and to the Canadian Bank as segregated reporting is required to the Canadian Bank given it is either/ both an FI under Chapter 4 or a QI/QDD under Chapter 3.

Let me know if you have any further questions.

Kind regards

Question 8.

Sigma

Sigma's classification would depend upon the property holdings, if the 95% holding in commercial property was direct holdings in real estate rather than through shares in a property holding company(s) the entity Financial Accounts for FATCA / CRS purposes would be limited to the residual cash holding with Sigma with FATCA / CRS classification depending upon the nature of income received e.g. if Sigma actively managed its portfolio of commercial property it could be determined that the passive income received by Sigma was less than 50% of the gross income therefore leading to Sigma being classified as an Active Non Financial (Foreign) Entity – Active NFE under CRS and FATCA. However if the rent received was not deemed active income but was rent from passive direct holdings or was income arising from equity and debt securities held in property holding company(s) Sigma would be self-assessed as a Passive Non Financial (Foreign) Entity – PNFE under CRS and FATCA.

SI LP

SI LP is a newly formed entity investing in securities generating passive income leading to SI LP being classified as a Passive Non Financial (Foreign) Entity ie a PNFE under CRS and FATCA. However as SI LP has placed 50% of its holdings with UK PB, (which would be a reporting FI under the UK/US Model 1 Intergovernmental agreement IGA[1]), and 10% of this holding is under a discretionary mandate with UK PB, then given the following:

1) UK PB is an FI and has discretionary authority to manage SI LP assets in whole or in part.

2) SI LP meets the Financial Assets test, which requires that at least 50% of SI LP's income is attributable to investing, reinvesting or trading in financial assets in the shorter of:

   a. The three year period ending on 31 December in the year preceding that in which the investment entity status is to be determined; or,
   b. The period in which SI LP has been in existence.

Then SI LP's financial accounts with UK PB will be classified as a Managed Investment Entity under CRS and FATCA.

As an FI which is a Managed Investment Entity, then under FATCA, SI LP may be classified as a Non Reporting Financial Institution: Certified Deemed Compliant, Owner Documented Foreign Financial Institution (ODFFI) under the US regulations to do this it would need to disclose all US Specified Persons who have:

1) A direct or indirect equity interest, looking through all entities other than specified US Persons; or,

2) A direct / indirect debt interest in excess of 50,000 USD (disregarding holding through FFIs).

And meets the following conditions:

Is not an intermediary; does not accept deposits in the ordinary course of banking; does not hold financial assets for others as a substantial part of its business; is not an insurance company; is not owned by or in an Expanded Affiliated Group with an entity which does any of the specified actions; does not maintain a Financial Account for a NPFFI and the entity if it is a trust does not have contingent beneficiaries or designated classes of beneficiaries with unidentified beneficiaries.

Given SI LP is an ODFFI for FATCA purposes, UK PB will report any identified US Specified Persons.

As a Managed Investment Entity under CRS, SI LP will be required to register with the UK Competent Authority and report any Financial Accounts, which for an Investment Entity is deemed to include any Equity or Debt interests.

Given Sigma's circumstances it would be classified as follows in this instance and the Reportable Persons would be as shown below.

FATCA

SI LP would classify as an ODFFI, reporting one US Specified Person on its Owner Reporting Statement (assuming the US Person, was a US Specified Person).

UK PB would report the US Specified Persons to HMRC the UK Competent Authority which would ultimately report this to the US IRS.

CRS

SI LP would classify as a PMIE resident in Cayman, with two Reportable Persons who are HK resident Equity owners and a Chinese resident Reportable Person who is Debt owner (the HK Trustee, although having ultimate effective control over the trust it is not a natural person).

SI LP would report the Cayman entity, the 2 HK Equity Owners and the Chinese debt owner to HMRC, the UK Competent Authority, who would ultimately report this information to Cayman, HK and Chinese competent authorities[3].

There is an assumption that [1]UK PB is a UK Financial Institution and the referenced [2]US Person is also a US Specified Person the exchange between Competent Authorities assumes that the [3]year being reported is 2018 or later as the HK bilateral exchange with the UK is not in effect until then.