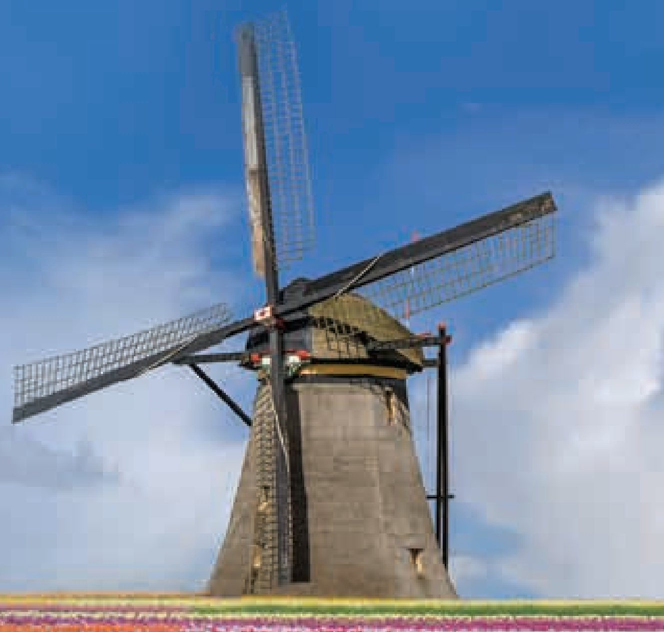
KPMG Global Sovereign and Pension Fund Tax Conference

September 2017
Amsterdam



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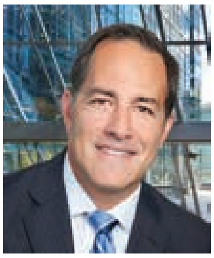
Foreword

In September, KPMG hosted its annual Global Sovereign and Pension Fund Tax Conference in Amsterdam. On the agenda were a range of key tax challenges and trends — from the impact of changing demographics, new investment markets, and technology, to managing and addressing regulatory changes. Through a series of facilitated discussions and collaborative break-out sessions attendees had the opportunity to engage with representatives from around the globe.

We hope that this summary report helps continue the dynamic debate and discussion that emerged from the conference. On behalf of the conference organizers and participants, I encourage you to take up the discussion with your peers, advisors, regulators and tax authorities.

To discuss these — or any other tax-related issues — please contact your local KPMG member firm or any of the contacts listed at the end of this report. And start planning today to attend the 2018 KPMG Global Sovereign and Pension Funds Tax Conference in Rome. We look forward to seeing you there!



David Neuenhaus

Global Lead — Institutional Investor Group

There are privileges and challenges of managing tax for sovereign and pension funds.

Gerard van Olphen, CEO of the large Dutch pension fund APG opened the Conference by framing challenges facing sovereign and pension fund tax managers: limiting tax leakage in an increasingly uncertain environment while remaining mindful that sovereign and pension funds have a public mission. Even with historically high investment returns, governmental boards ask sovereign and pension funds to create value, which includes generating both gains and minimizing tax loss. The math is shocking: for every 2 percent loss in returns, a would-be pensioner of 30 years of age must work an additional 7 years to adequately fund their retirement.

Then, Dr. Allen James, Head of Business Development of Hyperloop One, treated attendees to a description of the start-up pod-based vacuum transportation system. He reminded participants of the transformative nature of their capital and its power to help invent the future.

Demographics are destiny

Demographics impact sovereign and pension funds in fundamental ways. Grant Wardell-Johnson, Leader of the Australian Tax Centre in Australia, explained that a key element of the structure of a country's demographics is the ratio of producers to consumers. For example, in India there are 56 producers for every 100 consumers, whereas in Japan, there are 45 producers for every 100 consumers. Moreover, India's position will improve through to 2055 when there will be 58 producers to 100 consumers while Japan's position will decline from 45 to 36 by 2055.

The influence of a country's demographic structure ripples through a national budget in ways other than just net inflows and outflows. A younger country, for example, is more likely to spend on education and an older one on healthcare. There is a danger, however, in thinking demographics are just a function of birth and death rates. While important, an economy's structure is also influenced by religious attitudes, gender roles and migration. A country with a high percentage of working women will look very different from one that does not have a large population of women in the workplace. Wardell-Johnson argued that there are three types of countries from a demographic perspective each with their own challenges.

Low birthrate countries

Fertility rates worldwide are trending down leading some demographers to say that population will level out over time. In some countries like Iran which moved from 6.2 children per couple down to 1.4 in 30 years, the decline can be quite dramatic. Generally, birthrates are thought to inversely correlate with affluence. In the case of Iran, this appears to be the case notwithstanding governmental policy promoting higher fertility. However, this conventional wisdom is currently being questioned. In Nigeria, for example, rising wealth has not produced falling fertility. Low birthrate countries run the risk of having too many consumers relying on too few producers which can strain budgets and political cohesion.

Low birthrate/high migration countries

Both Germany and France have seen their birthrates decline dramatically over the past 30 years but their populations are relatively stable because their low replacement rates are augmented by a high number of migrants. While this phenomenon is helpful if you are funding a pension system, it can give rise to domestic resentments and a rising resistance to migrants. Migration is interesting — whereas once thought to only aid the destination country, there is a new body of evidence that suggests that the source country may benefit as well in the form of both rising remittances and a growing support for and interest in education.

High birthrate countries

India, Indonesia, the Philippines and South Africa all show positive demographics. Currently each of those countries have birthrates in excess of the 2.1 replacement rate. This trend is expected to continue.

Of course, demographics are not the only element that impacts whether or not a country is a good place to invest. Levels of corruption and inequality are also important factors to consider. That said, the increase in the Asian middle class is expected to rise from 1.7 billion people in 2020 to 3.0 billion in 2030. The implications of this are staggering in many different ways. It is an exciting world as well as an interesting one, as the Chinese maxim goes.

The state of holding jurisdictions

Simon Clark, Partner (KPMG in Singapore) facilitated a discussion with participants, including KPMG Partners Niels Groothuizen (KPMG Meijburg in the Netherlands), Steve Economides (KPMG Australia), Naz Klendjian (KPMG in the UK), Martin Reng (KPMG Acor in Denmark), Pierre Kreemer (KPMG in Luxembourg), and Michael Plowgian (KPMG in the US), on the status of holding jurisdictions in a post-BEPS, post-Brexit era.

According to Plowgian, more than 70 jurisdictions have signed on to the Organisation for Economic Co-operation and Development's (OECD) Multilateral Instrument (MLI), with a dozen or so more countries expected to sign in the near future, resulting in 1,100 treaties impacted. All of the signatories to the MLI included the principal purposes test (PPT), and how the PPT will be implemented is a key issue. The revised commentary to the OECD Model Tax Convention includes three examples of how the PPT could be interpreted in the context of investment vehicles that are not so-called collective investment vehicles (CIVs), but the examples do not provide clear guidance. KPMG continues to work with our institutional investor clients to help drive clarity on this matter, and ensure the interests of this group are represented.

Groothuizen outlined how the Netherlands is leading the way in implementing the MLI, including using the agreement as the basis for its budget and promulgating guidelines for how a substance (rather than a purpose) based test will be implemented in the Netherlands providing for zero outbound dividend withholding tax if the test is met. Kreemer stated the Luxembourg government is looking at the PPT closely, knowing that providing certainty will be important to global investors with entities in Luxembourg. He reported that there is a convergence between regulation and tax substance where the government's focus is on the true purpose of the entity. Reng stated the Danish taxing authorities can be skeptical of the substance of intermediary entities and are focused on looking through structures to see who the beneficial owner is. Clark noted that this is in line with what he has seen in certain other jurisdictions. According to Klendjian, the PPT is not itself a direct focus of the UK Treasury (given the UK does not levy domestic dividend withholding tax and does not see interest withholding tax as a revenue raiser), however they acknowledge that they may need to play a role in encouraging a pragmatic and consistent interpretation of the PPT across Europe and the OECD (where they acknowledge the examples may mean source countries feel empowered to take an overly strict or inconsistent approach). Plowgian noted that it is unlikely that the United States (US) will sign on for the PPT given the limitation of benefits provision in US treaties.

In response to the evolving holding jurisdiction environment, Clark reported that he is seeing more direct investments, sidecar arrangements (where investors are putting money to work alongside traditional structures), and even discussion around synthetic structures (where there is no entity formed and consortium participants are bound together by only contracts), freeing them to come to the investment by way of their own treaty network.

Promising investment geographies

David Dietz, a Managing Director with KPMG in the US, led a panel discussion with KPMG Partners Martin Reng (KPMG Acor in Denmark), Jerome van Staden (KPMG in the UAE), Carles Farre (KPMG in the US), and Adewale (Wale) Ajayi (KPMG in Nigeria) on investments into emerging markets, focusing on the opportunities and challenges for investments into Africa and the United Arab Emirates.

Africa

Wale reported being bullish on investing in African countries and particularly in Nigeria, Kenya, South Africa and Egypt. The 54 nations in Africa have an aggregate population of 1.2 billion and a landmass the size of the US, India and Canada combined. Africa's economy is growing at 5 to 6 percent annually, driven by swelling demographics that include 50 percent of the population under 15 years of age. Wale spoke of the opportunity to invest in infrastructure as particularly interesting though he cautioned it will require investors to think afresh about the investing model they use, stressing the need to actively engage with political leadership. By way of example, in Nigeria, with 190 million people, the economy grew at 4.5 percent before contracting — 1.5 percent during a recession this last year. He said by 2020, estimates are calling for 7 percent annual growth. The largest sectors into which investors are putting money are oil and gas, agriculture, telecommunications, wholesale and retail trade and manufacturing.

United Arab Emirates

Jerome van Staden reported that the UAE considers foreign direct investments (FDI) as a key part of its long-term economic plan and is focused on increasing FDI to a level of 5 percent of GDP (UAE Vision 2021 strategic plan). At the same time, it continues to focus on obtaining a number one rank for the UAE in the global index for ease of doing business. The UAE Vision 2021 strategic plan also aims for a place among the top 10 countries worldwide in the Global Competitiveness Index. The main opportunities for direct investment are in real estate, infrastructure projects, upstream oil and gas projects, financial services and private equity.

From a tax perspective, the Federal Tax Authority (FTA) was established a year ago to oversee and administer taxation in the UAE. More recently, the Tax Procedures Law, VAT Law and Excise Tax Law were enacted. VAT will go live on 1 January 2018 and taxpayers are busy with online registration. Although most of the emirates forming the UAE have independently enacted income tax decrees, a federal corporate income tax could come back in the next 2 to 3 years after the focus of the FTA on VAT is completed.

The European view

The European Union (EU) has aggressively moved forward on implementing BEPS, even going beyond the recommendations, reports Vinod Kalloe, a Partner with KPMG Meijburg in Amsterdam. The EU has a long history of collective action against aggressive tax planning. It is not surprising to see member states moving forward on anti-treaty shopping and transparency. In dramatic language, the EU recently announced it was putting together a black list of nations it felt were likely to take advantage of the multilateral BEPS process with plans to publish the list by the end of the year. It is also contemplating counter-measures against such states.

Interestingly with the UK leaving the EU, an argument can be made that the EU is becoming more energized. Germany and France, for example, have recently rejuvenated the EU tax agenda by forcing solutions on taxing the digital economy, for example. The European Commission is furthermore actively advocating that what has heretofore required unanimity (a high bar that the UK often kept the EU from clearing), be decided by majority vote. A new voting regime like this could result in the EU taking bolder stands.

The elusive promise of technology

Is it possible to underestimate the impact on technology in an era of smartphones and autonomous vehicles? Steve Rainey, Chief Innovation Officer, KPMG in the US, says it is. That is because technology's power continues to grow exponentially — as famously described by Gordon Moore who said the number of capacitors that would fit in a chip would double ever year, a phenomenon known as Moore's Law. Technology will transform tax as well. Computers process large data well and, increasingly, they will be asked to do that, replacing labor. This means the tax department will change as well. It will need tax knowledge and also technological knowledge to manage the technological investment.

For many sovereign and pension tax managers implementing technology can seem daunting. Rainey suggests doing easy things first and climbing up the ladder of complexity over time. He identifies three types of technology tax managers can use:

Basic process automation leverages a class of technology to automate rudimentary swivel-chair processes found in almost all organizations today. Many tax departments have begun exploring the use of bots to automate repetitive tasks. Basic process automation is akin to using a macro in Excel to automate a series of manual processes. Robotics is a new class of software that can drive a series of processes across several applications rather than a single spreadsheet. To drive robotics, software engineers are not necessary, tax professionals can be easily trained to integrate the applications.

Enhanced process automation is the next level of innovation and is a term that means something like 'smart automation.' Excel is structured data and easily searched and manipulated. Doing the same with unstructured data like emails and contracts is harder and requires natural language programming which learns the meaning of words in their context. Similarly, with machine learning, a computer develops algorithms to describe data and improves its ability to recognize important patters as the data set expands, giving it more experience.

The tools involved with enhanced process automation typically can:

— understand natural language and therefore interpret unstructured data, and

— use machine learning to develop a knowledge base by consuming significant amounts of data to learn and develop a set of algorithms, which is then used to make predictions about the data.

These tools are more complex and take longer to develop and implement than basic process automation. Also, these tools typically take longer to integrate into the environment, do not reside on the desktop, and may require connections to the cloud to gain the maximum benefits.

Cognitive automation describes the most complex technologies that includes the first two levels of computing but also begins to assign probabilities associated with different outcomes. Cognitive software mimics human activities such as perceiving, inferring, gathering evidence, hypothesizing, and reasoning. And, like humans, cognitive software is taught rather than traditionally programmed. The power of cognitive automation is its ability to ingest massive amounts of data and formulate hypotheses. The human brain cannot handle this volume of data and does not have the time to absorb it, let alone process it. When cognitive solutions are combined with automation, these systems can be trained to execute judgment-intensive tasks.

Instead of thinking about all problems in terms of either/or, cognitive automation begins to compute and communicate likelihoods. For example, IBM's Watson can be programmed to search transaction data and determine if an expense is likely deductible, not unlike a junior analyst. A tax shop would claim the deduction in the case of a high likelihood item, with the computer attaching its supporting authority, including precedential court cases, but flag more questionable transactions for review by a manager.

For more information on how technology will impact your tax department, please read this recent article by Steve Rainey featured in the September/October 2017 issue of Tax Executive Magazine.

Building the future

Infrastructure continues to be an asset class of interest for sovereign and pension investors. Panelists Matt Cuchra (KPMG in the UK), Ben Foulser (KPMG in the UK), and Mark Cruikshank (MIRA), led by moderator Justin Davis (KPMG in the US), discussed a number of trends changing the world of infrastructure:

- There is a shift from construction to customer service with projects focused on customer experience as a key driver of use.
- There is a shift toward technology fueling customer experience and maintenance. Drones are checking on infrastructure and devices are talking with each other, reducing cost and optimizing use.
- There is a shift toward thinking about how several large projects integrate with each other.
- At the same time, sub-projects are starting to be disaggregated from larger projects and funded on a stand-alone basis.
- With the cost of capital low, it is getting harder to make the case for private infrastructure projects versus the public funding of projects.
- Asset prices are going up, fueled by investment competition, which is driving down yields. Some investors are taking on riskier projects to hit target yields.
- Most jurisdictions are going out to bid on private structures reducing the incentive to proactively source opportunities.
- Different jurisdictions have different appetites for private infrastructure, mostly politically driven.
- There is a shift from investors being passive to them taking a more operationally active role.

The panel noted that energy is being disrupted and there are risks associated with legacy investments and opportunities to invest in new platforms. Similarly, in transportation, demand continues to fuel a need for more capacity, creating an opportunity which shifting regulatory regimes might imperil. At the same time the panel noted the entire asset class is being stained by overly optimistic estimates on usage which results in sub-optimal returns.

A non-executive board member's view of DExEU

Longtime KPMG veteran and champion of KPMG's Sovereign and Pension Tax Group, Margaret Stephens, is now a non-executive board member of, and advisor to, the UK's Department for Exiting the European Union (DExEU).

As she describes it, the UK wants a deep and special partnership with the EU characterized by the greatest possible tariff and barrier free trade, and continued cooperation in security, law enforcement and criminal justice. The government's vision for this partnership has been set out in the Prime Minister's speeches in Florence and at Lancaster House, and in a series of papers published over the summer. The UK is keen to negotiate a special treaty with the EU characterized by no tariffs and a special security arrangement that provides for expatriates of both the continent and the UK to live and work in each other's jurisdictions, an important item she characterized as 'citizens' rights.'

Objectives:

1. lead the UK's negotiations to leave the EU and establish a new partnership between the EU and the UK
2. work with the devolved administrations of Northern Ireland, Scotland and Wales, the Westminster Parliament, and a wide range of other interested parties (business, trade unions, civil society, local government and the public at large) throughout the negotiations
3. lead and coordinate cross-government work to seize the opportunities and ensure a smooth process of exit, including the transposition of EU law and amendments for the required domestic legislation, on the best possible terms
4. continue our work across Whitehall and in Brussels to ensure collective government on European business, exercise our rights and meet our obligations as a member of the EU until we exit; and
5. attract and develop great people and organize ourselves flexibly to deliver our objectives efficiently and effectively.

Priorities:

— ensuring the government is able to take decisions on our withdrawal and new partnership with the EU on the basis of the best possible advice

— overseeing the negotiations to establish a new partnership with the EU, based on the 12 objectives outlined in the white paper on the UK's exit from and new partnership with the EU

— continuous engagement with stakeholders to provide as much certainty as possible throughout the negotiations

— strengthening capability across government in preparation for the UK's exit from and new partnership with the EU

— delivering the Repeal Bill as part of a wider program of domestic legislation required for a smooth and orderly exit.

Stephens said the series of summer papers reflect the deep engagement the government has sought from external parties with expertise on each policy area, and draw on the very extensive work undertaken across government since last year's referendum. Stephens suggested that the white papers outline the government's vision for future policy and will be of interest to sovereign and pension managers. The UK knows and appreciates that sovereign and pension funds represent the people's money and carry with them a mission of public benefit, and therefore should be given special accord.

The fundamentals of the UK economy are strong, according to Stephens. The government is determined to get the very best deal for households and businesses and help the UK make the most of the opportunities ahead by laying the foundations of a stronger Britain outside the EU. The UK economy has seen 18 quarters of economic growth and low employment. However, the UK needs foreign investment and intends on setting up a taxing regime to support that aim, and it understands the needs to provide regulatory clarity to investors.

She encouraged the group to contact her directly at margaret.stephens@dexeu.gov.uk with any questions or input on the process.

To keep up to date with the government's engagements and progress in the negotiations, you can follow gov.uk and subscribe here to the DExEU stakeholder bulletin.

An update from the OECD

The Organisation for Economic Co-operation and Development (OECD) has been focused on the transition to the implementation phase of the BEPS project. In particular, the OECD has established the Inclusive Framework on BEPS, which brings together over 100 jurisdictions to collaborate on the implementation of the BEPS recommendations, including monitoring jurisdictions' implementation of the minimum standards. The first peer reviews with respect to the minimum standard on mutual agreement procedures are already underway, and jurisdictions are taking action to implement the standard.

The BEPS treaty recommendations are being implemented primarily through the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (commonly referred to as the Multilateral Instrument, or "MLI"). The MLI provides jurisdictions with many options that they can adopt, including anti-treaty abuse provisions. For example, jurisdictions can implement a PPT, a limitation on benefits, or a combination of the two. The OECD is focused on making sure the implementation is effective and will monitor implementation through peer reviews.

The OECD also understands the uncertainty of how the anti-treaty abuse provisions, including the PPT, will be applied, and is undertaking work to help taxpayers make effective claims for withholding tax relief. That work is particularly important in the context of investment funds and other intermediated structures. One possible approach to these issues is the approach set out in the Treaty Relief and Compliance Enhancement (TRACE) implementation package, which was approved more than 4 years ago. Since approval, most countries have not focused on the TRACE work due to the pressing issues raised by the BEPS project. Some governments and the OECD are now considering work that could build on the concepts of the TRACE project in an effort to reduce tax uncertainty. That said, other governments may have fatigue over these kinds of international initiatives. Perez-Navarro urged attendees to talk with their respective governments to let them know that these issues are an important priority that deserve further work

Around the world in 60 minutes

— **Australia:** Brendon Lamers (KPMG Australia), Gina Maio (AustralianSuper) and John Payne (New Zealand Super Fund) reported that the Australian Tax Office (ATO) is earning a reputation for being one of the more aggressive taxing authorities with efforts to restrict what qualifies as a sovereign, close oversight of pensions (particularly those participating in club deals), overreaching information requests, and changes in policy (on what can be done in infrastructure, for example). The effect some say, may scare away the required foreign capital. Still there is little to suggest that the ATO is changing its tune at this point.

— **India:** Girish Vanvari, Head of Tax, KPMG in India, reported that taxing authorities have rolled out 17 taxes into one comprehensive goods and service tax (GST) with a goal of eliminating the underground, non-taxed marketplace. This GST impacts how businesses think about their business models, profitability and cash flow going forward and will impact their business models. Export of services are generally exempt from GST. The new law is presently in its stabilization phase and once finalized, this along with demonetization would lead to increase the GDP of the country.

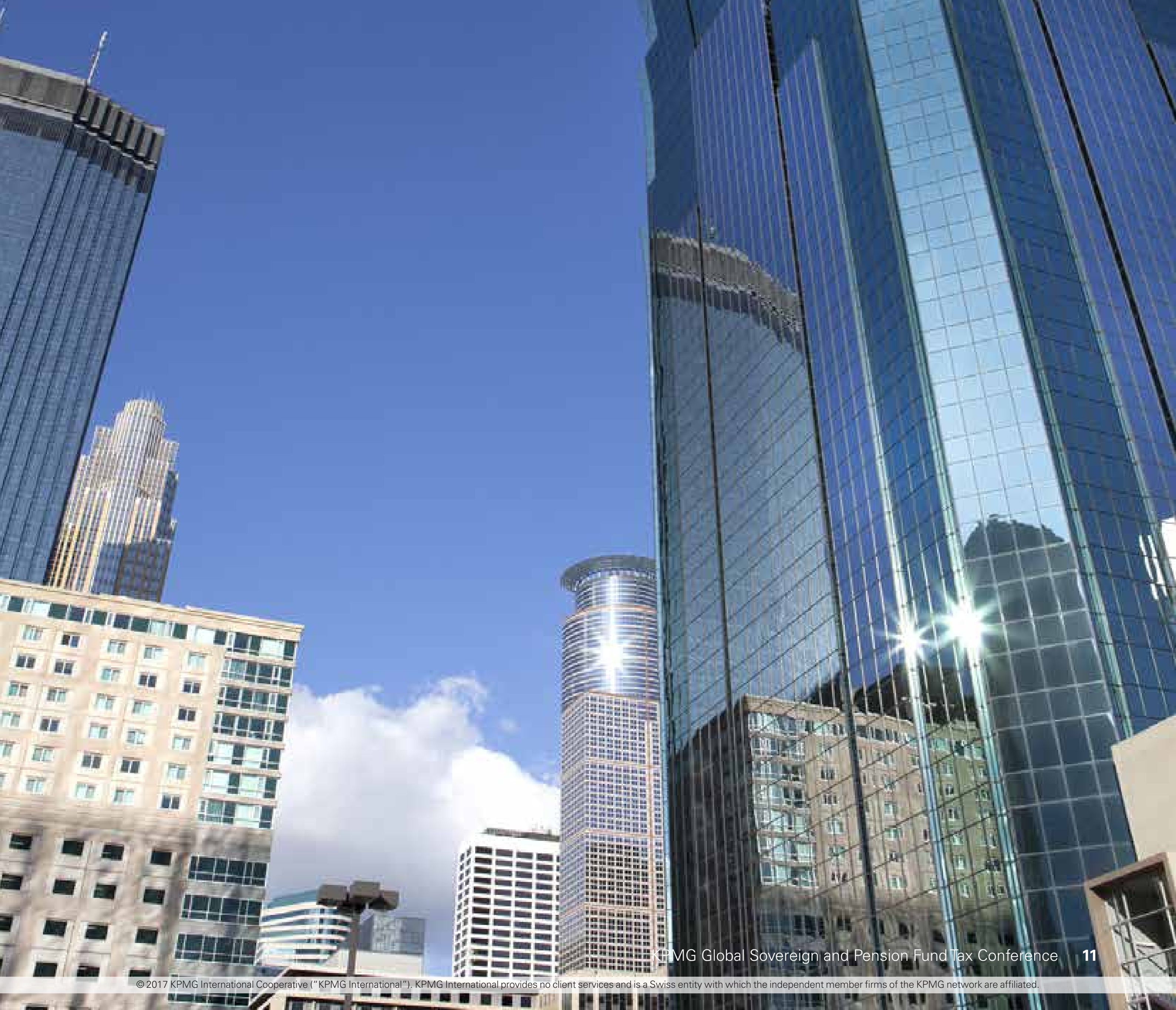
— **United States:** Michael Plowgian reported that the White House and Republican Congressional leaders recently released a framework for proposed tax reform. The framework proposes to cut the corporate rate to 20 percent and the rate for pass-throughs to 25 percent, though it did not provide much detail on so-called 'revenue raisers' like the exceptions or special tax breaks it would eliminate. That said, it appears the administration is supportive of further restrictions on the deduction of net interest expenses. The current manufacturing deduction would likely disappear. There would be some mechanism for repatriation of profits by US corporations and the US would move to a territorial system of taxation. For the Senate to take advantage of the 51-vote reconciliation process and avoid the potential of a filibuster, both the House and Senate must pass a budget that provides instructions regarding the tax bill. Most observers think that there is a relatively low chance of the US enacting in the near term tax reform as contemplated by the framework, though they think that a tax bill of some kind is likely to pass.

Closing

It is more important than ever that sovereign and pension fund professionals keep up to date with the ever changing global tax environment.

Our annual global conference continues to serve as an important industry event for funds, governments and advisors alike — to share real-world experiences and market leading best practices. It is through coming together as a community that we can educate, be informed and achieve greater success for our sector, our organizations and our beneficiaries.

We encourage you to continue the dialogue and bring your perspective to our 2018 Conference in Rome. In the meantime, we are planning regional events throughout the year, and our regularly scheduled Chief Tax Officer Exchange calls and meetings offer great global connection points. For more information, please contact David Neuenhaus, Meghan Meehan or any of our institutional investor colleagues on the back cover.



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