KPMG Global Sovereign Wealth and Pension Funds Tax Conference report

Rome, Italy

KPMG International

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Foreword

Dear Colleagues:

It was wonderful to see so many of you at our event in Rome this past September. Once again, attendees — government and OECD officials, executives from top pension and sovereign wealth funds, and KPMG professionals — engaged in dynamic and lively discussions and collaborative sessions focusing on the most pressing industry issues of the day.

We appreciate the opportunity to be part of the discussion and to bring together this community. The following report highlights some of the topics discussed at the conference. We encourage you to remain engaged and continue the conversations that emerged from the conference through our Chief Tax Officer calls, social events and other industry conferences that KPMG member firms will be hosting during the coming year. As always, if you have any questions please feel free to contact me or any of our KPMG Institutional Investor practice professionals directly — and we hope to see you at the 2019 Global Sovereign Wealth and Pension funds Tax Conference.

Best regards,

David Neuenhaus
Global Lead, Institutional Investors Group
Global Tax Lead Sovereign Wealth, Pensions and Infrastructure Networks
Principal
KPMG in the US

Geopolitics and tax risk

Rohitesh Dhawan, Eurasia Group, and **Dr. Greg French**, Australia's Ambassador to Italy, sounded similar themes as they kicked off the conference with keynotes at the opening dinner.

Dhawan emphasized that the sources of future uncertainty and risk are not primarily economic or structural — but political. As events unfold, countries led by very different leaders react in very different ways. In turn, this creates a new geography of choices to which other state actors are forced to react.

Similarly, Ambassador French spoke of the traditional tension between *Realpolitik* and *Idealpolitik*:

— *Realpolitik* sees nations as acting primarily in their self-interest, and its proponents argue for proportionate and symmetrical response to other states' actions.

— *Idealpolitik* sees nations as acting in step with their values, and its proponents argue for values-based international leadership.

French posited that this dichotomy is false — and that self-interest is a function of a nation's values. Australia's self-interest, for example, is informed by its love of liberty, the rule of law, tolerance and pluralism.

These themes set the stage for the rest of the conference. Over the next few days, attendees expressed the need to balance the pull of moral leadership — as shown by Organisation for Economic Co-operation and Development's (OECD) base erosion and profit shifting (BEPS) project and the European Union's (EU) directive on mandatory disclosure and transparency (DAC6) — against the cold realities of countries acting in their national interest, like the US's apparent disinterest in the Multilateral Instrument and Australia's new rules on for taxing foreign investment in infrastructure.

How the global tax landscape is shifting and how investors are responding

OECD's focus on digitalization

Jeffrey Van Hove, the newly-named senior advisor to the OECD's Centre for Tax Policy and Administration and acting head of treaties and transfer pricing, explained the OECD's work to forge a global consensus. Without that consensus, Van Hove fears the project will end with a patchwork of equalization measures and inconsistencies across jurisdictions.

The OECD is also focused on how to resolve tax disputes between countries and increase the level of certainty in the system, recognizing that the BEPS process was disruptive for investors.

In a question-and-answer session, conference participants urged Van Hove to remember that sovereign wealth funds and pension plans are unique public-benefit organizations and need to be treated differently than corporations or wealthy individuals. They also urged the OECD continue its progress in thinking about the principal purpose test.

Source country considerations

KPMG partner **Johanna Gerrie** moderated a panel discussion on investor perspectives: specifically how sovereign and pension funds view the world. Panelists included **Vince Berretta**, Sovereign Wealth Fund Institute (SWFI), and SWF Tax Directors from the UAE and Canada. The conversation ranged from investors' growing appetite for direct investments to the persistent enthusiasm for smart beta hedge fund managers

Key takeaways from the session included:

- Managers believe that trade wars and rising protectionism are the greatest threats to returns.
- Investors are moving more money to cash, partly to protect assets against a possible slowdown and partly to have cash in hand to pursue any opportunities that might arise.
- As the number of large direct investments increases, so does the number of satellite offices as investors seek to closely manage their key assets.
- Asset managers are increasingly partnering with local entities who both source the investment and actively monitor performance. Identifying partners is viewed as a key to success, particularly for developing countries.

Multi-party investing

KPMG partner **Marco Müth** moderated a panel discussion on how sovereigns and pensions work with other investors in joint ventures (JV) and consortiums.

Key takeaways included:

— JVs and consortiums can often be a means to access the higher returns and lower risks associated with larger direct investments.

— Multi-party investing is often attractive because it disintermediates fund managers whose interests do not always align with those of investors. Some participants indicated that general partners (GPs) may be viewed as seeking to earn higher fees or have a greater tolerance of risk than investors whose capital is being invested.

— Investing through a consortium structure allows tax managers to provide more input earlier in a deal.

— It is important that investment partners share the same values, including similar sensitivities to reputational risk.

— When investing more traditionally as an LP into broadly held funds, it is important to diligence the fund, the GP and the portfolio.

— Many investors are reducing the number of GPs they invest with, focusing on those that understand their particular organization.

— The sense in the room was that sovereign and pension funds will not increasingly move to disintermediate fund managers and serve as the GPs of the future; however the dependence and relationship will shift.

Environmental, social and governance considerations

KPMG partner **Minh Dao** moderated a panel discussion on how the sovereign and pension fund community thinks about environmental, social and governance (ESG) issues.

Key takeaways included:

— Investors are increasingly bringing ESG teams to the table when making investment decisions. They also actively monitor their portfolios with ESG concerns in mind.

— While most funds do not have prescriptive ESG tests, some have general exclusions, such as tobacco, nuclear or munitions. For some sovereign funds the general exclusions reflect certain religious beliefs, such as exclusions from investments in casinos and liquor industries. Many funds also seek to avoid investments that have adverse climate impact or a poor record of treating employees fairly.

— Funds use their voting power as investors to drive ESG agendas — but panelists sensed that funds need to be careful: If an investor becomes too active, could they put at risk their sovereign status?

— The panelists felt that their public stakeholders have a responsibility to weigh in on tax risk and that tax governance should not be left to regulators. Some participants felt it is increasingly important to publish statements of tax policy.

By video, **Matt Whineray**, the CEO of New Zealand Super, posited that while the media most closely follows how ESG considerations inform investment choices, ESG also drives how New Zealand Super identifies and mitigates risk inside its investments. ESG also informs what the fund believes constitutes responsible ownership, including a company's perspective on safety, human rights, labor relations and corruption.

Selected country updates

Italy

Over lunch, **Fabrizia Lapecorella**, Italy's Director General of Finance, Ministry of Economy & Finance, shared that Italy's government has made tax certainty a priority, conceding that tax policy has shifted in the past. The Ministry is focused on preventing treaty abuse and uses the principal purpose test to ensure investors are not avoiding tax. The Ministry believes taxpayers have a right to know whether they pass the test's thresholds. On significant investments, the Ministry is willing to provide clarity. The Italian government is also taking steps to adjudicate disputes more quickly and judiciously.

Australia

KPMG partner **Brendon Lamers** introduced **Jeremy Hirschhorn**, Australia's Deputy Commissioner for Tax, who spoke via video link about recent changes to the way Australia taxes foreign investors. Jeremy argued that Australia is focused on treating taxpayers fairly and is fully committed to implementing BEPS reforms. At the same time, Brendon noted that Australia receives a large of amount of inbound capital, which obliges the Australian Tax Office (ATO) to engage in transfer pricing policy. Other topics addressed include:

— *Stapled structures:* Jeremy argued that Australia is one of the last jurisdictions to allow stapled structures. While they were useful for attracting infrastructure investment, their use is spreading to other types of investments.

— *Data:* The ATO is focused on improving how it receives and uses data, and has dedicated 600 people to this task.

— *The Foreign Investment Review Board (FIRB):* When it comes to reviewing tax structures, the FIRB makes a recommendation to Treasury, which makes final decisions on what will be allowed. Treasury prefers low-risk tax structures when foreign capital is involved.

— *Tax disputes:* The ATO is aiming to reduce the number of disputes arising from interpretational differences. The ATO intends to make its positions clear so taxpayers can structure their investments in ways that align with the ATO's stated position.

United States

KPMG principal **Michael Plowgian** briefed participants on the state of US tax reform. Plowgian cautioned, however, that policy change in Washington can be unpredictable. This is shown by the recent US tax reforms themselves. Key takeaways included:

— Tax in the US has become more complex. It is critical for investors to model the effects of tax provisions at every stage of a transaction as some of these effects are counter-intuitive.

— The impacts of the base erosion and anti-avoidance tax (BEAT) in particular can be significant and counter-intuitive. While the talking points suggested that the provision targets non-US parented groups, it can affect US multinationals even more harshly than foreign investors. The key issue for investors and funds will be to determine whether their US investments are in-scope, noting that the BEAT generally does not apply to investments that are less than 25 percent owned or that have less than USD500 million in US gross receipts on an aggregated basis (receipts generally must be aggregated when an investor owns more than 50 percent of an entity).

— Tax reform also brought significant changes to certain reporting requirements, including changes to the definition of controlled foreign corporations (CFCs) that greatly expand the number of reportable CFCs. Obtaining the information required to be reported has been a key focus for many groups.

— The qualified foreign pension fund (QFPF) exception, which exempts QFPFs from the Foreign Investment in Real Property Tax Act (FIRPTA), also has been amended, and future regulations may provide additional clarity.

United Kingdom

KPMG partner **Naz Klendjian** chaired a conversation with **Angela Simons**, Head of International Business Tax, HM Treasury, who updated the group on the tax landscape in the UK. Key takeaways included:

— The UK was active in the BEPS process, and is now an early adopter of the resulting recommendations. The UK is keen to get input from affected stakeholders to make sure its reformed tax regime is fair.

— The UK does not think that its exit from the EU will diminish its influence on international taxing norms.

— Among the wider international tax reforms, the continued uncertainty with the principal purpose test (PPT) seems to have provoked the most comment for funds who have global investment structures. The UK's view is that the principal purpose test is an objective test informed by facts and circumstances and the UK, through its role at the OECD, hopes to encourage tax authorities to develop clearer and more practical guidelines in this area to reduce uncertainty.

— Brexit is requiring Treasury to navigate a number of challenges, including corporate tax, digital entities, the UK's tax base, and potential UK tax reform.

— The UK supports the transparency called for in the country-by-country reporting provisions. However, it also believes that this kind of pubic reporting can only be effective if it is a multinational effort. Unilateral adoption would damage a nation's competitiveness.

Letting it all sink in

Participants broke out into facilitated peer-to-peer exchanges to discuss what they had heard and to benchmark their strategic responses against the responses of peer sovereign and pension funds. During a 'speed dating' session, participants had a chance to dig into issues of interest in China, India, the US and the UK.

How tax departments are adapting to the new tax geography

KPMG partner **Peter Grant** set the stage for the day's discussions by sharing the following model for assessing the relative maturity of a tax organization across six dimensions.

Enterprise Tax considerations

KPMG partner **Rachel Hanger** moderated a panel of industry experts focusing on enterprise and operational tax challenges sovereigns and pensions encounter, including tax function design and increasing pressures on global compliance and reporting obligations. Key takeaways included:

— Organizations are seeking the opportunity to become more technologically agile. 'Small wins' are a necessary first step to prove the value of technology to stakeholders. And, the fear of non-compliance is a powerful driver for automation.

— There is a need to convince senior executives of the importance of investments in tax technology.

— Tax technology must align with the overall financial architecture of the entity. A tax director cannot move in a silo.

— Functional alignment is an important first step toward process automation. There is a need for a different skillset in the future as technology becomes more embedded in the tax function.

— Career paths are needed for people in organizations with small tax functions. Without an upward path for professionals, recruiting and retaining talent is a challenge.

— While many organizations hired almost exclusively from the Big 4 in the past, they are now increasingly looking elsewhere, specifically for technologists.

		I = Initial	O = Optimised	
Governance and risk	No formal tax policy or tax risk management framework	I	O	Board approved and documented tax policy and risk management framework
Organisational Model	Limited consideration given to design of the organisational model for tax	I	O	Organisational model designed to take into account tax strategy, risk and business needs
People and Capability	No formal career development paths or training programmes	I	O	Clear career development paths and training programmes available
Process & Responsibility	Processes are not standardised or documented and have unclear responsibilities	I	O	Standardised and documented global processes with clearly defined responsibilities
Data and Information	Financial data has to be significantly re-worked before it can be used by tax	I	O	No re-work of data required and data can be relied upon by tax
Technology and Data	Reliance on spreadsheets and low level of automation	I	O	High level of automation and range of tax technology implemented

Tax technology

US firm partner and Global Head of Technology and Innovation **Tim Gillis** kicked off a series of TED-style talks on tax technology issues by speaking to the trends he sees.

— **Technology is roiling tax:** Technology is and will radically change the tax profession as provision and compliance work are automated and data collection is increasingly digitalized.

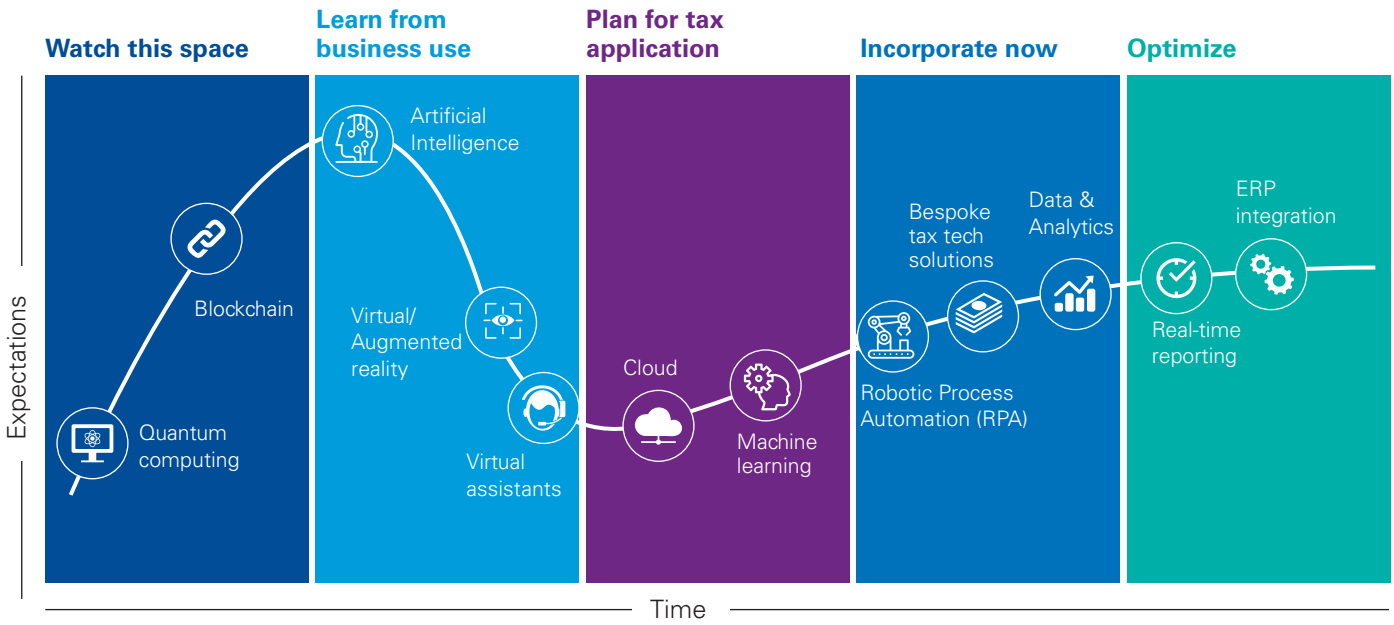
— **Tax is getting more complicated:** Assets under management are increasing. Sovereign and pension funds are hunting farther afield and venturing into new geographies in pursuit of returns. Tax law and regulations are growing more complex.

— **Data is exploding:** The amount and quality of data is driving greater specialization, changing productivity measures, informing policy changes and disrupting business models.

— **The technology imperative:** Tax managers are being driven to invest in technology because tax authorities are increasingly asking for digital tax reporting. Tax departments are eager to realize a return on investment by automating tax and reducing headcounts.

— **Technology will drive tax policy:** There is evidence that jurisdictions will increasingly prefer to impose tax where the data is easiest to collect, e.g. through VATs.

— **The importance of knowing what is real:** There is an adoption curve for tax technology, as shown by the diagram below,



Source: KPMG International

Technology launches

— **KPMG Global Asset Management Hub:** KPMG in the US director **Dave DuBan** spoke about the Global Asset Management Hub, which aggregates data from across the investment portfolio and allows our clients to view that data by geography, asset class, performance and deliverables. The Hub also enables the analysis of trends over time across different lines of services, investment strategies and jurisdictions powered by business intelligence tools.

— **KPMG LINK Business Traveler:** KPMG in the UK director **Michelle Berners Price** introduced KPMG LINK Business Traveler, a web application and mobile app which tracks travelers and assesses the tax, social security and immigration risks associated with each business trip. She noted that technology like this has moved business traveler compliance from the 'too difficult to handle' box into a manageable one, helping companies to navigate an environment of increased pressure to comply.

— **KPMG Fund Analytics Tax Engine:** KPMG Australia partner **Damian Ryan** presented the KPMG Fund Analytics Tax Engine — a tax engine which transforms the traditional approach to tax compliance for a managed fund, through a use of automation, analytic and visualization tools. The automation tools allow for the secure transition of custodian data to the tax engine. Analytics are then able to run over the data to identify any outliers. Visualization tools provide a visibility not previously available in one place. Finally, elodgement capability allow for electronic lodgment of the return with the tax authority.

— **Tax and blockchain:** KPMG in Canada senior manager **Frankie Davenport** presented blockchain technology and taxation, predicting that this peer-to-peer system of value exchange would revolutionize tax collection. She noted that many countries are already implementing blockchain technology in their governmental processes, and that supranational bodies including the WEF, the OECD, and the EU are also exploring its applications.

Conclusion

To close the conference, **David Neuenhaus** moderated a panel, sharing some final thoughts on the promise and peril inherent to the rise of technology's use in tax including:

— Technology will reduce the reliance of jurisdictions on income tax, both personal and corporate, because income is inherently hard to measure.

— Holistic technological solutions trump piecemeal efforts.

— When tax managers decide to build as opposed to buy, product development governance is critical. Managers need to track how something was built so that it can evolve over time to react to changing tax policy.

— When moving forward with technology, it is important to manage the change with people at the same time. Sometimes, this change management can be as or even more difficult than taking the next step with technology. Without buy-in, technological initiatives do not succeed.

Given the challenges and opportunities that face institutional investors today, it is critical for Sovereign Wealth and Pension fund professionals to keep up-to-date with the latest developments in the ever-changing global tax environment. Our annual global conference serves as an important industry event for funds, governments and advisors alike — to share real-world experiences and market leading practices. We hope that this conference report, and our ongoing alerts, updates and thought leadership throughout the year, help continue the dynamic debate and discussion that emerged from the conference and add to the growing pool of knowledge on the taxation of sovereign and pension funds.

As always, we look forward to working together and continuing our conversations with you.

Contacts

KPMG Sovereign and Pension Fund Tax Network

Global Lead

David Neuenhaus
Principal
KPMG in the US
E: dneuenhaus@kpmg.com

ASPAC

Daniel Joe
Seconded Partner
KPMG in the US
E: djoe@kpmg.com

John Timpany
Partner
KPMG China
E: john.timpany@kpmg.com

Angus Wilson
Partner
KPMG Australia
E: arwilson@kpmg.com.au

Minh Dao
Partner
KPMG Australia
E: mdao@kpmg.com.au

Brendon Lamers
Partner
KPMG Australia
E: blamers1@kpmg.com.au

Adam Gibbs
Partner
KPMG Australia
E: amgibbs@kpmg.com.au

Simon Clark
Partner
KPMG in Singapore
E: simonclark1@kpmg.com.sg

Bruce Bernacchi
Partner
KPMG in New Zealand
E: bbernacchi@kpmg.co.nz

EMA

Peter Grant
Partner
KPMG in the UK
E: peter.grant@kpmg.co.uk

Rachel Hanger
Partner
KPMG in the UK
E: rachel.hanger@kpmg.com.uk

Naz Klendjian
Partner
KPMG in the UK
E: naz.klendjian@kpmg.co.uk

Mikko Saressalo
Partner
KPMG in the UK
E: mikko.saressalo@kpmg.co.uk

Niels Groothuizen
Partner
KPMG in the Netherlands
E: groothuizen.niels@kpmg.com

Marco Müth
Partner
KPMG in Germany
E: mmueth@kpmg.com

Pierre Kreemer
Partner
KPMG in Luxemburg
E: pierre.kreemer@kpmg.lu

Martin Reng
Partner
KPMG Acor Tax
E: martin.reng@kpmg.com

Ria Falk
Partner
KPMG Acor Tax
E: ria.falk@kpmg.com

Adewale Ajayi
Partner
KPMG in Nigeria
E: adewale.ajayi@ng.kpmg.com

Stuart Cioccarelli
Partner
KPMG Lower Gulf
E: scioccarelli@kpmg.it

David Dietz
Seconded Managing Director
KPMG in the US
E: ddietz@kpmg.com

Americas

Jill Cosentino
Managing Director
KPMG in the US
E: jillcosentino@KPMG.com

Johanna Gerrie
Partner
KPMG in Canada
E: jgerrie@kpmg.ca

Stephen Eng
Partner
KPMG in Canada
E: seng@kpmg.ca

Michael Plowgian
Principal
KPMG in the US
E: mplowgian@kpmg.com

Jesse Eggert
Principal
KPMG in the US
E: jeggert@kpmg.com

Candice Turner
Principal
KPMG in the US
E: candiceturner@kpmg.com

Justin Davis
Seconded Partner
KPMG in the US
E: justindavis@kpmg.com

Carles Farre
Principal
KPMG in the US
E: cfarre@kpmg.com

Sam Riesenberg
Principal
KPMG in the US
E: sriesenberg@kpmg.com

Greg Wiebe
Partner
KPMG in Canada
E: gwiebe@kpmg.ca

Jocelyn Blanchet
Partner
KPMG in Canada
E: jblanchet@kpmg.ca

Nicholas Kato
Partner
KPMG in Canada
E: nhkato@kpmg.ca

Julio Castro
Partner
KPMG in the US
E: julioacastro@kpmg.com

Carla Hannemann
Partner
KPMG in Canada
E: carlahannemann@kpmg.ca

kpmg.com/socialmedia

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