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FOREIGN COUNTRY RULES FOR TAXING THEIR RESIDENTS' INVESTMENTS IN NONRESIDENT INVESTMENT COMPANIES

March 17, 1993 TO: TAX COMMITTEE NO. 13-93 INTERNATIONAL MEMBERS NO. 8-93 RE: FOREIGN COUNTRY RULES FOR TAXING THEIR RESIDENTS' INVESTMENTS IN NONRESIDENT INVESTMENT COMPANIES ____ This memorandum discusses how several foreign countries tax their residents' investments in offshore funds. The applicable laws are designed, in part, to achieve the same result as the passive foreign investment company, or "PFIC", rules of the United States: to deny taxpayers the tax deferral advantages of investing in passive assets through an entity organized in a jurisdiction other than that in which the taxpayer is resident. In addition, such rules may serve to encourage investments in domestic entities, thus aiding the domestic investment industry. Belgium: Article 250 of the Income Tax Code provides that, in the case of the sale or contribution of (among other items) stocks, bonds and cash to any foreign company that benefits from a tax regime more favorable than the Belgian regime (i.e., because the income is taxed at a lower rate in the foreign country than in Belgium): (1) the sale or contribution will be disregarded by Belgium, (2) the Belgian investor will be treated as still owning these assets and (3) any income derived from those assets will be taxed to the Belgian transferor. The taxpayer may avoid such tax by showing either that there was a legitimate business reason (other than the decision to invest abroad) for the transfer or that the transferor received consideration for the transfer which produces taxable income in Belgium that is taxed at a rate comparable to the tax that would have applied without the transfer. 11 SICAV (Societe d'invetissement a Capital Variable) is an open- end investment company organized in corporate form. 22 UCITS (Undertakings for Collective Investment in Transferable Securities) refers to the types of funds authorized under a directive of the Council of Ministers of the European Communities aimed at coordinating the laws, regulations and administrative practices of such undertakings. In principal, Article 250 may apply to Belgian investors in Luxembourg and other funds, including but not limited to SICAVs 11 and UCITS22 funds, not located in Belgium and to other types of foreign investment companies. Foreign investment funds generally pay no tax in their home country, and in that respect benefit from a favorable tax regime. Also, the interests in the funds which the Belgian resident purchases do not typically generate taxable income in Belgium, as most such funds do not distribute any income and, under normal Belgian tax principles, capital gain on the sale of the fund interests is not taxed in Belgium. However, domestic Belgian investment funds offer tax treatment almost identical to that of the foreign funds, making it unclear whether there is in fact any sort of favorable tax treatment from investment in the foreign fund. The Ministry of Finance has declared that Article 250 generally will not be applied against a Belgian resident who is a shareholder in a non-Belgian domiciled fund where the shareholder is not a "major" holder in the fund. The statement does not define the term major. France: France has no specific laws with respect to the taxation of investments by French residents in foreign funds. Germany: Germany has three main sets of rules applicable to investments by German taxpayers in non-German investments: the controlled foreign corporation ("CFC") rules; the foreign investment fund ("FIF") rules; and the passive foreign investment company ("PFIC") rules. The rules overlap and may apply simultaneously to the same foreign investment company. The CFC rules apply to all German owners in a foreign corporation controlled by German residents which earns passive income and which is subject to a low tax rate. Passive income is defined as all income other than that listed in the statute ("listed income"), and can include much more than investment income from securities. Listed income includes income from manufacturing and marketing, certain service activities, certain banking and insurance businesses, certain renting and leasing activities, and the financing of non-German business activities. Control for these purposes means more than 50 percent ownership by German residents. To avoid being considered low-taxed, the foreign corporation need not actually pay a high effective tax rate; the corporation may benefit from deductions and credits which would also beavailable under German law. An effective tax rate of less than 30 percent would generally be considered a low tax rate. CFC shareholders are attributed their pro rata share of all of the distributed and undistributed net income of the fund for the year. CFC income will not be attributed to a German shareholder if (1) not more than 10 percent of the foreign company's income is passive, and (2) the total foreign income attributable to the German shareholder from different sources does not exceed DM 120,000. An FIF is any diversified foreign fund investing in securities or real estate. The treatment of German resident shareholders depends on whether the fund is registered for sale in Germany and, if not, the degree of information on the fund's income provided to German resident shareholders. Unlike a CFC, control of the fund by German residents is irrelevant, as is the level of taxation of the fund in the foreign country. For FIFs which are registered for sale in Germany, German resident shareholders are attributed their pro rata share of all net income, other than capital gain. Distributed capital gains received by individuals with respect to fund shares held other than in the course of the individual's trade or business are not taxed. Distributed capital gains received by individuals as income from business activities and all capital gain distributions received by corporations are taxable. Undistributed capital gain is not taxed. A second method of tax applies to FIFs which are not registered for sale in Germany but which appoint a "tax representative" who supplies detailed information on the fund's income. Shareholders in these types of FIFs are allocated a pro rata share of all distributed and undistributed income, including capital gain. The final method of FIF taxation applies to a FIF which is not registered for sale and which either has no tax representative in Germany or which does not provide detailed information. Shareholders in these FIFs are taxed on all distributions and on 90 percent of the increase in the net asset value of the fund from the beginning of the calendar year to its end, with a minimum taxable income of 10 percent of the year-end net asset value. The final system for taxing shareholders invested in non- German resident funds deals with PFICs, which are defined in a similar manner to CFCs, but without a control requirement. That is, a PFIC is a non-German controlled foreign corporation which earns "passive income with an investment character" (hereinafter, capital investment income) and which is subject to a low tax rate. Capital investment income is more narrowly defined than under the CFC rules, and specifically includes income derived from holding, administering, maintaining, or increasing the value of monetary items, claims, securities, participations or similar investments. If a foreign entity is a PFIC, any 10 percent or greater shareholder is allocated his or her pro rata share of the capital investment income of the PFIC, and is subject to tax on that income. A shareholder in an entity which is both a PFIC and a FIF presumably would be subject to tax under whichever system results in the largest amount of taxable income. It is not clear how a PFIC shareholder would obtain the required information as to his or her pro rata share of income if the PFIC refused to provide such information. Greece: Greece has no specific anti-avoidance rules, in part because Greece has imposed severe restrictions in the past on the removal of capital from Greece for investment abroad. However, a Greek resident is taxable on the distributed and undistributed income (but not capital gains) of either a domestic or foreign investment fund. Ireland: An Irish corporate or individual resident is usually not liable for tax on undistributed income or capital gain of any fund, foreign or domestic. However, if an investment is deemed to have been made by an Irish resident for the purpose of avoiding Irish income tax, the undistributed income of the foreign fund can be attributed to the Irish resident. Upon the sale of an interest in a non-distributing offshore fund, any gain will be treated as ordinary income. To qualify as a distributing fund, an offshore fund has to meet both a requirement to distribute at least 85 percent of its annual income and certain investment restrictions. Italy: Italy has no anti-deferral laws with respect to investments by Italian residents in foreign funds. Japan: Japanese individual and corporate shareholders in a foreign company may be subject to controlled foreign corporation ("CFC") rules. Thereunder, they could be taxed on the foreign company's undistributed income if the following conditions are satisfied: (a) the taxpayer holds directly or indirectly, alone or as part of a group, 10 percent or more of the share capital of the foreign company; (b) at least 50 percent of the share capital of the foreign company is held by Japanese residents; and (c) the foreign company is designated as a 'tax haven company'. We understand that legislation will provide that a company subject to foreign tax at an effective rate of less than 25 percent may be designated as a tax haven company. Certain exemptions from these rules exist, but are unlikely to be applicable to foreign investment companies. Luxembourg: Luxembourg has no specific laws with respect to the taxation of investments by Luxembourg residents in foreign funds. Netherlands: Resident individuals holding non-Dutch funds are deemed to have received income annually of 4.8 percent, 6 percent or 9 percent of the value of such funds' shares, determined as of the beginning of the year. The 4.8 percent rate is used if less than 50 percent of the fund's assets are in deposit accounts, bonds or other similar debt instruments. The 9 percent rate is used where more than 70 percent of the fund's assets are in such instruments. The 6 percent rate is used for all funds which have assets consisting 50 percent of more of passive investments, but equal to or less than 70 percent, with passive investments defined to include debt obligations but not shares in corporate entities. Actual distributions are taxed to the extent that they exceed the deemed amount. Residents may also prove that their actual share of income earned is less than the deemed amount. It should be noted that amounts payable by foreign funds on redemptions of shares by Dutch investors may be deemed to be dividend distributions and taxed accordingly. Therefore, Dutch individual investors typically attempt to sell, rather than redeem, their shares because capital gains generally will be tax free. Residents are not taxable on the gains from sales of non- Dutch fund shares unless (1) ownership of the shares is connected with a Dutch trade or business or (2) the taxpayer owns a substantial portion of the fund (defined as 7 percent of the total shares for married persons or 33 1/3 percent for individuals, including shares owned by certain relatives and attributed to the taxpayer). Corporate shareholders owning 25 percent or more of a non- resident fund which is invested 90 percent or more in portfolio investments must mark the fund to market each year and take into account for income tax purposes the amount of gain or loss thus determined. The participation exemption under which dividend income in certain circumstances is exempt from Dutch income tax does not apply to most investment companies, because that exemption does not apply to shares held solely for investment. Portugal: Portugal has no specific laws with respect to the 33 FCP (Fund Communs de

Placements) is an investment fund organized as a trust. taxation of investments by Portuguese residents in foreign funds. Spain: Spain has no specific laws with respect to the taxation of investments by Spanish residents in foreign funds. Sweden: Sweden has no specific laws with respect to the taxation of investments by Swedish residents in foreign funds. Switzerland: Under the Swiss federal system, taxes may be imposed by (1) Federal laws, which apply to the entire country, (2) Cantonal laws, effective in the territory in which enacted, and (3) by certain municipalities and churches. Any description of tax laws with respect to foreign funds can thus be only a general discussion. Swiss residents are not subject to tax on undistributed income and gains from nonresident funds. Nor are they subject to tax on the gain from sale or disposition of a nonresident fund, other than in the Canton of Graubunden. United Kingdom: Taxation will in part depend on the form of the investment fund. An FCP33 will be treated as transparent for tax purposes, so that all income and gain retains its character as taxable income (if such income or gain otherwise would be taxable to a direct holder) whether or not it is distributed. If the fund is in corporate form, there will be no tax on undistributed income and gain, unless the fund is a controlled foreign corporation ("CFC"). A CFC is defined as a fund organized in a low-tax jurisdiction where profits are effectively taxed at a rate of less than half the U.K. corporate tax rate of 35 percent, and where more than 50 percent of the capital of the fund is held by British residents. In that case, any British corporation with a 10 percent or more ownership share of that fund will be taxed on its pro rata share of the fund's income. However, if the fund follows an "acceptable distribution policy" (that is, if it distributes 90 percent or more of its income annually), the income attribution will not apply to a 10 percent or more corporate shareholder in the fund. These provisions do not apply to individual investors in offshore funds. If an offshore fund organized as a corporation does not distribute at least 85 percent of its income each year, any gain on the disposition of the fund's shares will be treated by both individual and corporate holders as ordinary income and not capital gain. * * * * * We will keep you informed of developments. David J. Mangefrida Jr. Assistant Counsel - Tax