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COMMON CONTRACTUAL FUNDS

The Tax Efficiency in Asset Pooling

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What is a Common Contractual Fund?

The Common Contractual Fund ("CCF") is an Irish tax transparent structure first established in 2003. It was specifically developed to enable asset managers and asset owners pool their investments (primarily in the context of pension fund assets) in a tax efficient manner.

The CCF is an unincorporated body established by an Irish management company pursuant to which investors participate and share in the underlying investments of the CCF. Each investor in the CCF is deemed to hold an undivided co-ownership interest in the underlying investments of the CCF as tenant in common with other investors. Units issued in a CCF are not shares but serve to determine the proportion of the underlying investments of the CCF to which the investor is beneficially entitled.

A CCF can be established as a UCITS pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2011, as amended or as an Alternative Investment Fund ("AIF") pursuant to the EU (Alternative Investment Fund Managers) Regulations, 2013. Tax transparency is the main feature, which differentiates the CCF from other types of Irish funds structures. CCFs established as UCITS or as AIFs are authorised and regulated by the Central Bank of Ireland.

CCF – Key Tax Benefits

The tax efficiencies within any asset pooling solution are critical to the success of the solution to meet investor demands. The CCF has firmly established its' tax transparent credentials over the last 10 years and a number of large asset managers and asset owners (including multinational corporations with pension assets) have established CCFs benefiting from their tax efficiency and other non-tax benefits.

- The CCF benefits from Ireland's competitive tax regime providing certainty, stability and transparency.
- Over 70 funds have been established since its creation in 2003.
- It is transparent for Irish legal and tax purposes.
- The CCF can avail of tax transparency in over 20 markets of investment.
- Similar to all Irish regulated funds, the CCF benefits from a tax neutral regime; no subscription/financial transactions tax or other capital taxes, no taxation of income/gains and no net asset value tax.
- The CCF is best placed to meet the demands of institutional investors and asset managers for a tax efficient and flexible cross border asset pooling solution.
- VAT efficiencies can be created for institutional investors pooling assets in a CCF compared to maintaining assets in segregated or separately managed accounts.
- Intellectual and IT infrastructure dealing with asset pooling from a custodial, fund accounting, legal and tax perspective is based in Ireland. This allows asset managers and institutional investors implement complex asset pooling structures in an efficient and timely manner.

CCF – Non-Tax Benefits

As the CCF is tax transparent it allows pension funds and other institutional investors pool their investments, creating economies of scale resulting in lowered costs, while maintaining withholding tax benefits which could otherwise be lost through traditional 'opaque' investment vehicles. The keys benefits of a CCF as an asset pooling structure are as follows:

- The CCF offers economies of scale compared to fragmented investment products and strategies with different investment managers, administrators/ and custodians resulting in lower costs and enhanced investor returns.
- It also facilitates more efficient governance and risk management for pension trustees and other stakeholders.
- Solvency II also gives rise to opportunities to use the CCF, especially for insurance companies who will be looking to manage their capital adequacy requirements.
- CCFs can also be used as an efficient pooling master vehicle under UCITS IV allowing direct investment for institutional/pension funds seeking tax transparency and opaque feeders for retail investors.
- The CCF is a flexible structure to meet the demands of asset owners such as multinationals and can be established as a single or multi-fund vehicle, with single or multiple managers.

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CCF – An Illustration of the Tax Transparency Benefits

The tax efficiencies within any asset pooling solution are critical to the success of the solution to meet investor demands. The CCF is treated as tax transparent in over 20 markets including Australia, Canada, Germany, Italy, Switzerland and the US. In addition, it is a key policy goal of the Irish tax authorities to enshrine tax transparency into all new double tax agreements.

The tax transparency benefits of a CCF are real and provide enhanced investment returns. The table below illustrates the withholding tax cost or "drag" in a traditional "opaque" corporate vehicle relative to the benefits of using a CCF

Withholding Tax Cost ("Tax Drag")

(The withholding tax cost is illustrated as a percentage of the dividend yield of the MSCI World and MSCI Europe indices.)

PENSION INVESTORS	DIRECT INVESTMENT	CORPORATE UCITS	CCF UCITS	CCF BENEFIT
MSCI World				
UK	0.06%	0.44%	0.06%	0.38%
Netherlands	0.07%	0.44%	0.07%	0.37%
Switzerland	0.08%	0.44%	0.05%	0.39%
MSCI Europe				
UK	0.14%	0.24%	0.06%	0.18%
Netherlands	0.18%	0.24%	0.08%	0.16%
Switzerland	0.30%	0.24%	0.09%	0.15%

A simple but important example of this is US equities. Generally, pension funds in key markets such as the UK, Switzerland and the Netherlands are entitled to a 0% rate of withholding tax on US dividends while investments made through corporate vehicles (e.g. VCCs, SICAVs, ICVCs) and other tax opaque vehicles would incur withholding tax at a rate of 15% or 30% (depending on the domicile of the fund and the respective double tax treaty with the US).

For example, taking an investment of $1bn in US equities with an annual dividend yield of 2%, using a CCF would create annual tax savings of either $6m (30%) or $3m (15%) compared to a traditional 'opaque' collective investment vehicle. Considering the scale and relative importance of the US equity market (i.e. US equities constitute 54% of MSCI World Index), the benefits of using a CCF are clear.

While the benefits of tax transparency in the US market have been well publicised in the past, the broader recognition of the CCF has meant that the benefits of tax transparency go well beyond the US market. In addition, some European investment markets have updated their domestic laws to reduce and/or eliminate the withholding taxes on dividends paid to UCITS or similarly regulated investment vehicles (e.g. France, Spain and Sweden). This has provided the potential of additional tax efficiencies being created for pensions and other institutional investors pooling investments in a CCF authorised as a UCITS.

For example, a UCITS CCF investing in global equities would generate an annual withholding tax cost of 0.06% compared to 0.44% for a UCITS corporate vehicle. On an investment of $1bn with an annual dividend yield of 2.428%, this equates to a withholding tax cost of $0.6m for the CCF and $4.4m for the VCC resulting in an annual saving of $3.8m when utilising a UCITS CCF.

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Withholding Tax Cost ("Tax Drag")

Due to the long term investment requirements of pension plans (and schemes), the cumulative benefit of the tax savings generated by a CCF over the life of an investment increases the net returns. The table illustrates the increased return generated over the long term from investment in a UCITS CCF compared to a UCITS corporate vehicle for global equities. The illustrated benefit is exclusively due to reduced withholding tax costs and does not incorporate any of the non-tax benefits associated with CCFs.

CCF – Summary

With a ten year track record the CCF has established its tax transparency credentials in the global investment markets making it the tax efficient asset pooling structure of choice. The key characteristic of a CCF is its transparency in Ireland both from a legal and tax perspective (it is tax transparent from an income and capital gains perspective), resulting in its recognition as tax transparent in over 20 global markets to date. Unlike some other pooling products which only have some of the legal or tax characteristics of transparency, the benefits of tax transparency within the CCF make it best placed to service complex asset pooling needs now and into the future.

Global Equities: Net Dividend Return ($ Millions) on $1bn Investment

	3 YEARS	7 YEARS	10 YEARS	15 YEARS	20 YEARS
Corporate	60.90	147.90	217.80	343.89	483.04
CCF	72.69	177.91	263.54	420.32	596.54
Benefit	11.79	30.01	45.74	76.43	113.50

Over a 20 year investment period the reduced tax costs associated with a UCITS CCF would create additional investor returns of $114m based on a $1bn investment (ignoring capital appreciation).

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