19 January 2010

APPLICATION OF TAX TREATIES TO STATE-OWNED ENTITIES INCL. SOVEREIGN WEALTH FUNDS
PROPOSED CHANGES TO COMMENTARY OF THE OECD MODEL TAX CONVENTION.

Part A - Taxation of "Sovereign Wealth Funds"

1. A large number of States do not uniformly recognize the customary international law principle of sovereign immunity and its application to taxation. As the OECD discussion correctly points out, where States do apply sovereign immunity to tax, there is still great variation in its application. However, we suggest that the tax status of "Sovereign Wealth Funds" is also a matter that goes to the heart of the "comity of nations".

1.1 In the "Santiago Principles", the International Working Group of Sovereign Wealth Funds ("IWG") agreed that a generally accepted principle and practice of its members was that "SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate" (GAPP 15). In mutual respect for the laws and institutions of other States, the IWG had an expectation that host countries would not subject SWFs "to any requirement, obligation, restriction or regulatory action exceeding that to which other investors in similar circumstances may be subject" (Commentary to GAPP 15). We believe that this expectation should apply to the taxation of SWFs.

1.2 There are two aspects to this expectation. Firstly, States should not adversely discriminate between SWFs and other foreign investors or between SWFs from different foreign States. Secondly, and perhaps more critically, States should not discriminate between SWFs and domestic investors, particularly domestic Government investment institutions. Thus if a State does not tax its own Government investment institutions it would be consistent with the "comity of nations" for the State to also not tax foreign Government investment institutions.

1.3 Of course, the "comity of nations" also embraces reciprocity between States. As a growing number of States establish their own SWFS, it increasingly makes sense for States with SWFs to agree not to tax each other's SWFs.

Part B- Definitions

2. The Abu Dhabi Investment Authority ("ADIA") welcomes the initiative by the OECD to clarify the application of Article 4.1 of the OECD Model Tax Convention. The current definition of "Tax Resident" includes a "State and any political subdivision or local authority thereof". ADIA is of the view that this definition alone is inadequate to cover Government investment institutions such as "Sovereign Wealth Funds". Particularly in light of the growing numbers of Government investment institutions and their important role as cross-border investors, ADIA believes that it would be helpful for the OECD to suggest clarifying text for Article 4.1. On this matter we have the following observations:

2.1 It should not be presumed that all Government investment institutions are "state-owned entities". Rather they may be an "integral part" of a Government that, for example, has an "independent legal identity" with a "full capacity to act". (See Article 2.2 of "Emirate of Abu Dhabi Law No. (5) of 1981 concerning the re-organisation of the Abu Dhabi Investment Authority".)

2.2 Accordingly, it would be helpful to include within the definition of a State etc., any “integral part” thereof. The Commentary could consider defining “integral part” in terms of performing a function or being a governing authority of a foreign country (c.f. 1.892-2T(2), IRS Temporary Regulations).

2.3 For defining a “Tax Resident” to benefit from a tax treaty, an inclusive definition of “state-owned entities” should be used. Such a definition might be worded as “any person (other than an individual) owned or controlled directly or indirectly by that State or any political subdivision or local government thereof”.

2.4 It is appreciated that when particular tax treatment for a Central Bank or Sovereign Wealth Fund is included within a tax treaty (such as sovereign tax exemption for all or some types of income and gains), a more exclusive definition may be appropriate, such as:

“a Central Bank of a Contracting State and any integral part of, or person, agency, instrumentality, institution, authority, fund, enterprise, organization or other entity owned or controlled directly or indirectly by, a Contracting State or any political subdivision or local government thereof that is:

(i) generally exempt from taxation in that State; and

(ii) incorporated, organized or operated principally to invest funds to provide financial resources for the benefit of the Contracting State or any political subdivision or local government thereof.”

2.5 ADIA further accepts that States may also wish to ensure that sovereign tax exemption is not given to income from “commercial activities” or to “income that may inure to the benefit of private persons”. Further discussion on this, particularly with regard to what constitutes “commercial activities” should be encouraged.

2.5 With reference to such questions as: what kinds of entities should be eligible for sovereign tax exemption; what kinds of income should be exempt; and what kinds of tax exemptions will apply? We take note of the Australian Government’s timely issuance of a consultation paper in November 2009 entitled “Greater certainty for Sovereign Investments”.