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Fr: Korean CIV Consultation Group ("KC2G")

Subject: Comments on the Proposed Model Treaty Commentaries and  
Best Practice on CIV

This document is to set forth the comments on the two reports of the Informal Consultative Group on the Taxation of Collective Investment Vehicles ("CIV") and the Procedures for Tax Relief for Cross-Border Investors on two subjects: namely, (1) the Granting of Treaty Benefits with Respect to the Income of CIVs (hereinafter called as "Report on Granting Treaty Benefits") and (2) Possible Improvements to Procedures for Tax Relief for Cross-Border Investors (hereinafter called as "Report on Best Practice"). Both reports were released by OECD on January 12, 2009.

By way of introduction, KC2G, formed by several CIV related tax experts in Korea, is to react to OECD's series of actions to grant tax treaty benefits to CIV's income. See Annex 1 of the members of the group.

We appreciate the BIAC/ICG and OECD's efforts to grant tax benefits to CIV. The two reports have tried to introduce the direction and structure in handling major issues on which we would like to make specific comments in this document.

#### 1. Definition of CIV in light of company law and of "funds of funds"

In the proposed Paragraph 6.8 of the Commentary Changes, we wonder if the reference to the "investor-protection regulation in the country in which [the funds] are established" is sufficient. We suggest that the reference, at the outset, be made as to a legal form, with a list of well-defined legal feature in a separate report. We note that the subject of legal form is discussed in Paragraph 6.16 of Commentary Changes and Paragraph 21 to 23 of the Report in connection with "person." But, "funds in a legal form that are widely-held . . ." may improve the current draft (underscored a suggested insertion). In addition, a list of legal feature may well be provided separately.

As pointed in the Reports, some member State appears to have differences in flexibility in the legal form or legal feature of CIV while others have similarities in the legal form due to company or other related laws. For example, some States have common issue that a management office is used as one of the criteria in deciding a country of residence or allowing the immigration or emigration of a company. Diversity, however, in legal form appears to be one of the impediments to make the CIV to take treaty benefits in its own right.

The Korea's new Financial Investment Services and Capital Market Act (the "Act") has adopted similar concept of CIV. The Act was promulgated in August 2007 and became effective on February 4, 2009. Six previous acts based on the Act were repealed and consolidated to one; among other related associations, the Asset Management Association of Korea merged in effect the Korea Financial Investment Association ("KOFIA") on the same date with the Act. With these recent changes in investor-protection regulations, we see it will be difficult to grasp the general flow of the proposed commentary that does not have references to the underlying company law in a definition section, which is fundamental to the investor-protection regulations. Accordingly, we recommend that a reference be made in Paragraph 6.8 in regard to a legal form, followed by a well-defined list of legal features or attributes, or more specifically, an internationally recognized practice of company laws in the country where the funds are established.

In Paragraph 4 of the Report on Granting Treaty Benefits, the CIV definition includes funds of funds. We concur with the approach and appreciate the government's concern over the characteristics of such funds.

## 2. Relief by Source Country

We concur on the point that the reduction of double taxation should start from a source country. ICG primarily focuses on dividends, and to a lesser extent, interest income distributed by CIV (Paragraph 37 of the Report on Granting Treaty Benefits). Capital gains were excluded due to the Model Treaty's adoption of resident country taxation. Nevertheless, several member States made reservation to the model treaty provision. For such states to deal with the capital gains issue, the Report may well limit qualified CIV to those who have investments in publicly traded securities or the like with a minimum holding percentage.

## 3. CIV as a Person under the treaty

We would agree that the CIV may be treated as a Person under Treaty. Our new Act mentioned above defines a "collective investment" as "an activity of managing monies that were raised by soliciting more than two investors in a way of acquiring, disposing of, or otherwise managing investment assets with property values without any ordinary direction from the investors or each fund manager . . .", granting legal independence to the collective investment. [Emphasis underscored.] This provision may be supportive to the last part of Paragraph 29 where the beneficial owner issue was discussed.

Due to the rather diverse legal form and function of CIV, and the general perception of the term "beneficial owner," we recommend that the OECD / BIAC focus on a broader scale to get consensus among member States and outreaching to non-member countries. To do so, OECD / BIAC finally can reflect specific problems of other countries in properly developing treaty or protocol language for CIV.

#### 4. Approach to "good investors"

We would concur with the comments in Paragraph 33. CIV has frequent changes in owner investors, investment portfolio, and sometimes, the function and nature of the fund. It will be great burden for CIV to follow each and every change of its investors. However, holding through layers of intermediaries would be a different issue, and would need to be further explained by examples.

#### 5. Second and Third Proposed Treaty Provisions

First and fourth exemplary treaty provisions are clearer than the second and third. In the second provision, the term "equivalent beneficiary" relies mostly on policy consideration as set forth in 6.16 and 6.17. We would like to see more of the work in dealing with the difference in legal form and tax treatment in the two Contracting States, and application of domestic law and other convention that provides a rate of tax at least as low as the rate claimed under this Convention. Examples that use these treaty languages in light of policy consideration must be useful for the CIV industry to recommend treaty negotiation to respective government sector.

The third provision, the second alternative clause, carries a percentage of owners of the beneficial interest in the CIV. We do not know circumstance to use this approach, but will be interested in examples of application of the clause.

#### 6. Beneficial Owner (Annex 1)

We appreciate ICG's efforts on this issue in spite of the limited resources. The annex seems to need an expansion in order to present more balanced analysis. The analysis would be enforced by the history of the term, Beneficial Owner, member State's interpretation of the term, certain State's court's decision on the term, and others.

#### 7. Role of Intermediaries in the Best Practice Report

In Paragraph 6, the reference of securities depositories is useful. We recommend that in terms of respective banking regulations, the reference should be effective in real name financial accounts that most of the member States have. In addition to the phrase "DRs are typically held in street or nominee name via financial institutions that are members of the national CSD in the country of investor," perhaps another phrase could be introduced "without violation of the real name requirement in such State."

#### 8. Standard of Care in the Report on Best Practice

We applaud to several exemplary practices, in reference to "standard of care" in paragraphs 135 and 136. Some States appear to impose onerous burden on a withholding agent with no rules under which the withholding agent may be released from his obligation *vis-a-vis* the government. Consequently, the withholding agent tends to take an extremely aggressive posture in applying treaty rates or domestic law rates; in some instances, the agent is more aggressive than the government's in order to maximize his protection of his interest from future actions of the government. In

addition to a series of points in VI, ICG may refer to the presumption rule of a State and experience under which the withholding agent presumed the information provided by the taxpayers are correct and reliable. More details may be adequate along with the standard of care in paragraphs 135 and 136.

#### 9. Certificate of Residence in the Report on Best Practice

We concur with the view in paragraphs 142 ~ 144, in regard to reduction or elimination of reliance of certificates of residence. A majority of member States appears to have reduced their reliance over such certification, and need a new series of rules to replace the former system.

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