



Att. Mr. Jeffrey Owens
Director CTPA
OECD
2, Rue André Pascale
75775 Paris
France

Brussels, 23 December 2008

Discussion draft on a new article 7 (Business Profits) of the OECD Model Tax Convention

Dear Mr. Owens,

The European Private Equity and Venture Capital Association (EVCA)¹ welcomes the opportunity to submit comments on the discussion draft on a new Article 7 (Business Profits) of the OECD Model Tax Convention².

Established in 1983 and based in Brussels, EVCA is a member-based, non-profit trade association, which represents, promotes and protects the interests of the asset class.

The private equity and venture capital industry began to develop in the United States in the 1960s and 1970s, and only in the early 1980s did it begin to grow in Europe. In many respects, the industry has for the first time since the foundation of the OECD a chance to address the issues raised by the consultation.

Private equity and venture capital investments are long-term by nature, providing equity capital to companies across all stages of their development. The industry continuously looks to expand into new markets, often across national borders. In this context, the private equity and venture capital industry and more specifically the funds which are used as investment vehicles (which are either opaque or transparent for fiscal purposes³) for their institutional investor base, are often confronted with the issue of a possible presence of a permanent establishment and the discussion on the income to be allocated to such a permanent establishment.

Some tax authorities approach the permanent establishment issue for private equity and venture capital funds very severely whilst others do not. Further difficulties arise for the industry when not all OECD countries interpret the principles of the Model Tax Convention in the same way. Such uncertainty not only makes the whole investment process more burdensome but moreover might lead to double taxation.

The issue on the presence of a permanent establishment, which belongs to the application of Article 5 of the OECD Model Tax Convention, and the issue of income allocation, which belongs to Article 7 and is the subject of this consultation, are inherently connected. In this respect, EVCA would like to take the opportunity to invite the Committee of Fiscal Affairs of the OECD to further dialogue on these related issues based on, amongst others, interaction with its Tax and Legal Committee.

In terms of Article 5, the main issue seems to be whether the fund managers are capable of creating a permanent establishment of the investors or of the fund in the different countries where the management activity is carried out. In our understanding the fund managers should generally be viewed as independent agents acting in the ordinary course of their business, similarly to what happens to investments in public equities on the basis that, whilst they may be managing just one or a small number of

¹ www.evca.eu

² http://www.oecd.org/document/48/0,3343,en_2649_33747_40970288_1_1_1_1,00.html

³ The most common fund vehicle in Europe is the limited partnership.

funds, those funds generally comprise the investments from a broad spread of investors. However, currently in some jurisdictions the risk exists that the fund managers would create a permanent establishment to foreign investors or the fund.

Turning specifically to Article 7, the key element should be the allocation of income deriving from the management activity carried out in different countries when a permanent establishment of the management company is created. In our understanding, while on the one hand it is evident that an arm's length compensation for the management activity should be allocated to the permanent establishment, it should on the other hand be clarified that the management income to be allocated never includes the investment proceeds (which are referable to the fund and to the investors).

One suggestion for future discussion could be the inclusion of specific paragraphs for fund managers in the commentary on Article 7 and (possibly) on Article 5 in order to give the tax authorities of the different OECD countries clear guidelines and have univocal interpretation as far as possible. Inconsistent interpretation of the Articles in different jurisdictions limits the eagerness of investors to participate in funds which reduces the assets available in the private equity and venture capital markets. If the Committee of Fiscal Affairs of the OECD would be open to such an addition, the EVCA Tax and Legal Committee would be prepared to actively participate in the analysis and to assist in the provision of relevant information.

To conclude, in this current period of financial instability, private equity and venture capital can play a particularly important role in providing an alternative route to capital and access to management expertise that can help companies overcome deteriorating market conditions. Furthermore, with the reticence from the banking industry to provide finance (including equity and debt) for business acquisition and growth, the private equity and venture capital industry might therefore have to play a crucial role in the global economic recovery in general and more specifically the financial system. With private equity and venture capital firms typically investing for five or six years and often longer, the industry offers an antidote to the "short-termism" which has contributed to the current problems, and will also be able to support viable businesses that may be sold off by large corporations in the short term as they focus on 'core' activities.

To enable the industry to fulfil its potential, addressing the issues contained within the current implementation of both Article 7 and Article 5 as outlined above will prove highly useful.

EVCA remains at the disposal of the OECD for further discussions and can be contacted via the address below.

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