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Dear Ms Perez-Navarro

OECD discussion draft - Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention

A. Introduction

We are writing to provide the BVCA's comments on the OECD's discussion draft entitled "Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention" published on 12 October 2011 (the "Discussion Draft").

B. About the BVCA

The British Private Equity & Venture Capital Association (BVCA) is the industry body and public policy advocate for the private equity and venture capital industry in the UK.

The BVCA Membership comprises over 230 private equity, midmarket and venture capital firms with an accumulated total of approximately £233 billion funds under management; as well as over 220 professional advisory firms, including legal, accounting, regulatory and tax advisers, corporate financiers, due diligence professionals, environmental advisers, transaction services providers, and placement agents. Additional members include international investors and funds-of-funds, secondary purchasers, university teams and academics and fellow national private equity and venture capital associations globally.

C. Comments

1. Section 23 of the Discussion Draft addresses certain issues described in the Report of the Venture Capital Tax Expert Group on "Removing Tax Obstacles to Cross-Border Venture Capital Investments" published on 30 April 2010 (the "Expert Report"). We are grateful to the Working Group for considering the issues described in the Expert Report.
2. However, we are naturally disappointed that the Working Group did not consider that more specific guidance could be provided to the venture capital industry, as requested in the Expert Report.

We firmly endorse the comments made in section VI. of the Expert Report. The need to adopt operating and legal structures which ensure that the VC Fund Manager and its personnel do not have authority to create contractual relationships which bind the VC Fund or its investors has a distortive impact on the cross-border activities of VC Funds. Those structures are restrictive and expensive. Removing the need for those restrictions would allow Fund Managers to simplify the processes used in making and managing investments.

We would respectfully ask the Working Group to reconsider the request in the Expert Report for published guidance that Fund Managers and their personnel will generally be regarded, in relation to VC Funds and their investors, as agents of independent status acting in the ordinary course of their business.



We endorse the comments made in the Expert Report explaining why Fund Managers and their personnel should generally be viewed as independent agents. In particular:

- (a) Fund Managers normally provide their services to VC Funds in which a disparate group of investors have invested, including a significant number of third party investors who otherwise have no economic or legal connection to the Fund Manager;
- (b) Fund Managers are normally paid an arm's length fee for their services;
- (c) Fund Managers are not normally subject to detailed instructions or day-to-day control by the investors in the VC Fund; and
- (d) Fund Managers normally bear the risk of their business activities, in the sense that any poor performance is likely to result in reduced future fee income.

We acknowledge the comment made by the Working Group that the facts and circumstances of arrangements may vary. However, we would hope that it would be possible to describe in general terms the normal kinds of arrangement in which Fund Managers would be regarded as independent agents, whilst noting that the same view will not necessarily apply in other, more unusual cases.

We would, of course, be happy to provide the Working Group with information and other assistance required to formulate the appropriate guidance.

3. We have noted the proposed guidance set out in Paragraph 126 of the Discussion Draft to the effect that:
 - in the case of a fiscally transparent partnership, references to an “enterprise” mean, in the context of Article 5 of the Model Tax Convention, the partnership itself;
 - a venture capital fund set up as a transparent limited liability partnership would therefore be viewed as a distinct “enterprise”, carried on jointly by the limited partners and the general partner, in the context of Article 5 of the Model Tax Convention. (We assume that the reference to a “limited liability partnership” here includes limited partnerships – venture capital funds are normally established as limited partnerships rather than “limited liability partnerships”);
 - the reference in Article 5(5) of the Model Tax Convention to a person acting on behalf of an enterprise and having the authority to conclude contracts in the name of that enterprise should therefore be applied in relation to the partnership, rather than each investor in the partnership; and
 - similarly, for the purposes of Article 5(6) of the Model Tax Convention, the independent status of a fund manager should be determined in relation to the partnership, rather than by reference to each investor in the partnership.

It is not entirely clear to us what the practical impact of this approach would be in the context of VC Funds and Fund Managers. Our main issues are as follows:

- (a) Firstly, it is not clear to us whether this approach would make it less likely that a Fund Manager would be treated as acting as agent of independent status, on the basis that (all other things being equal) an agent who acts for a single principal is generally more likely to be treated as “dependent” on his principal than an agent who acts for a number of principals. Paragraph 38.6 of the OECD Commentary on Article 5, for example, states that “[A] factor to be considered in determining independent status is the number of principals represented by the agent. Independent status is less likely if the activities of the agent are performed wholly or almost wholly on behalf of only one enterprise over the lifetime of the business



or a long period of time. However, this fact is not by itself determinative...”. In the case of VC Funds, the commercial reality (as well as the legal position) is that Fund Managers are acting for the benefit of, and are accountable to, the investors in the VC Fund, rather than the fund itself. Is it intended that the proposed guidance will tend to make it more likely that a Fund Manager is viewed as a dependent agent? If so, we would strongly object to that approach. If that is not intended, then we would ask that this should please be made clear in the guidance.

- (b) Secondly, we would also ask that it is made clear in the proposed guidance that nothing in that guidance is intended to cast any doubt on the transparency of fund partnerships more generally in other treaty contexts (ie. in the context of articles other than Article 5).
- (c) Thirdly, assuming that our concern in (a) above is not an intended result of the proposed guidance, we take it that the proposed guidance would assist in cases where a Fund Manager is acting independently from the majority of investors in a VC Fund but is not acting independently from a minority of investors. In such a case, we assume that the proposed guidance would assist in reaching the view that the Fund Manager is not a permanent establishment of any of the investors (including that minority of investors).

It is conceivable that there could be circumstances in which the opposite is the case, namely that a Fund Manager is acting independently from a minority of investors in a VC Fund but is not acting independently from a majority of investors. In such a case, we assume that the proposed guidance would make it less likely that the Fund Manager would be viewed as an independent agent of any of the investors (including the minority of third party investors). It is possible, of course, that any investor who would be prejudiced by the approach set out in the proposed guidance might wish to contend that the Fund Manager is acting independently from them, notwithstanding the proposed guidance, and we would reserve the right of our members to take such a position.

Please feel free to contact me if you have any queries about this letter.

Yours sincerely,

David Huff
Chairman, BVCA Taxation Committee