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The Association of Investment Companies (AIC) is the trade association for the closed-ended investment company sector, representing some 350 investment companies. These include UK investment trust companies, Venture Capital Trusts (VCTs) and non-UK investment companies (usually domiciled in the Channel Islands). These non-UK investment companies are closed-ended collective investment companies whose shares are publicly listed, usually on the main market of the London Stock Exchange. We also represent a number of UK REITs.

Introduction

The purpose of double tax treaties is to prevent double taxation and promote cross border trade and investment. Any measures to protect the abuse of double tax treaties must not frustrate the fundamental objectives of the treaties. The public policy benefits of collective investment funds are well documented. Most countries have a tax system that provides for neutrality between direct investments and investment through collective investment funds (used in the sense of CIVs and non-CIVs, as defined).

International diversification of investment portfolios has become increasingly significant. As more investments are made cross-border to gain access to a wider pool of investments and to hedge currency and market risk, the question of treaty access is increasingly important. Collective investment funds represent a key source of investment capital. It is essential that this capital is available for cross border investment and the long term financing of economies.

Achieving tax neutrality between direct investment and investment through collective investment funds in an international context is as important as achieving tax neutrality domestically. Restricting the availability of treaty benefits to collective investment funds reduces investor returns and threatens their viability as a savings and investment product.

The local law recognition of a collective investment fund is of fundamental importance to this debate. If a collective investment fund is recognised by national law then such a fund and any subsidiaries of the fund should benefit from treaty access, regardless of the jurisdiction of residence of the beneficial owners of interests in the fund.

In the case of publicly traded closed-ended collective investment companies, the companies have no control over who purchases their shares in the secondary market. Their securities are often held through nominees. They therefore do not know who their beneficial owners are. The investment strategy of such companies is
not driven in any way by the residence or tax position of its investors. That said, they are subject to tax-information sharing arrangements, as are other financial entities in the chain of ownership.

Q1: What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

UK tax legislation uses a number of measures to ensure that a tax-advantaged collective investment undertaking is “widely held.” This includes:

- the “close company” test for investment trusts, UK REITs and VCTs;

  Broadly, the close company test is that the company must not be controlled by five or fewer participators, broadly, shareholders and certain loan creditors, or any number of participators who are directors. Shares held by any company which is not itself a close company are ignored. Notwithstanding the general test, provided that shares carrying not less than 35% of the voting power in the company are held beneficially by the public (as defined) and such shares have within the preceding 12 months been traded a recognised stock exchange, the company will not be treated as close. However, this exemption will not apply when substantial shareholders (i.e. greater than 5%) own collectively more than 85% of the company’s voting shares.

- the “genuine diversity of ownership” test for property authorised investment funds, tax elected funds, qualified investor schemes;

  There are three requirements for the genuine diversity of ownership condition to be met:

  o The fund’s documentation must state that the fund will be marketed and made widely available to specific intended categories of investors;

  o The terms and conditions of the fund should not be set in such a way as to limit investors to a select group within the stated categories of investors by deterring a reasonable investor within the target market from investing in the fund;

  o The fund must be marketed and made available sufficiently widely to reach, and in an appropriate manner to attract, the intended categories of investors.
• imposing an additional tax charge on REITs paying a distribution to a corporate investor with a 10% or more beneficial interest in the vehicle unless the REIT can show that it took reasonable steps to prevent this from happening.

The intention of any test should be to exclude vehicles which are ‘private’ or only available to specific individual or corporate investors, whether such a limitation is achieved by a specific rule set out in the fund documentation or by the imposition of terms and conditions that would have the effect of deterring investors outside such a limited group.

The AIC recommends that requirements of this nature are sufficient for a CIV and non-CIV to be widely held.

It should be borne in mind that institutional investors often have significant holdings in collective investment funds so institutional shareholders such as pension funds, other collective investment funds etc should not be considered as single investors.

Q2: What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know you customer rules”).

The AIC recommends that the minimum regulatory requirements should be left to each jurisdiction to decide. European jurisdictions could decide to specify collective investment funds which meets the requirements of the UCITS Directive or where the CIV has a manager that is authorised or regulated under the Alternative Investment Fund Manager Directive (AIFMD).

If the OECD mandates a particular regulatory framework, the AIC recommends that the framework should consist of requirements for:

• a spread of risk test in relation to a concentration of investments;
• the fund is widely held; and
• a published investment policy.
The AIC **recommends** there should not be a prohibition on the CIV acquiring a controlling interest in a company as some collective investment funds invest in private equity and acquire a majority stake. Alternatively, some collective investment funds have a mandate to invest in property and may do so through a special purpose vehicle, which may well be a wholly owned subsidiary of the vehicle. Such investments should be permissible provided the CIV satisfies a spread of risk test.

The AIC **recommends** that there should be no restriction or prohibition on particular types of investments, provided that the overarching spread of risk test is met and the investment policy of the fund is clearly set out. Different underlying investments meet different investor needs as to capital or income or diversification within the investor’s portfolio.

Leverage can increase the risk/reward of investment in a CIV but does not change the fundamental characteristics of CIV, which are set out above. The AIFMD requires a maximum leverage limit for each AIF, demonstrating to the regulator that these are reasonable and complying with them at all times. There are also requirements to disclose leverage information to potential and existing investors and to submit data to the national regulator which is then collated at a European level. In extreme cases, the regulator has the power to impose restrictions on the level of leverage that an AIFM can employ. The AIC **recommends** that there should be no prohibition on leverage in the CIV.

Q3: Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

If an investor is located in a different jurisdiction from the fund, any distributions and taxation of any gains would depend on the treaty between the jurisdiction of residence of the investor and the jurisdiction of residence of the fund (assuming the fund is opaque). It is a matter for the jurisdiction of residence of the fund to ensure the appropriate treaty provisions in treaties with other jurisdictions.

In the case of publicly traded closed-ended collective investment companies, the companies have no control over who purchases their shares in the secondary market and therefore who their beneficial owners are. The investment strategy of such companies is not driven in any way by the residence or tax position of its investors. However, these funds are subject to tax information sharing obligations such as the Common Report Standard (CRS).
Q4: Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would the concerns about deferral of tax be addressed?

One of the requirements of the investment trust regime in the UK is that the investment trust company may not retain more than 15% of its income. This ensures that all the income cannot be rolled up in the investment trust company. The ability to retain a small proportion of income allows commercial flexibility while still protecting tax revenues. It allows, for example, investment trust companies to “smooth” dividend payments so investment trust companies can maintain dividend payments when the level of underlying income received by the investment trust company has fallen. Depending on the precise definition of “regulation”, an investment trust company may or may not be a “CIV.”

In the UK, anti-avoidance legislation prevents income being rolled up in a non-UK fund, which may or not be a non-CIV. This prevents income being converted into capital gains on a sale of interests in the fund by a UK investor. This is significant where a UK taxpayer would be subject to a higher rate of tax on income than capital gains. If a fund falls within the definition of “offshore fund” its UK investors will be subject to income tax or corporation tax on income on any gain realised on a disposal of their interest in the offshore fund unless it is a reporting fund (i.e. the fund reports its income and the UK investors pay tax on the reported income of the fund, regardless of whether it is distributed or not). UK investors in a reporting fund are subject to capital gains tax or corporation tax on gains on any such gain.

Question 5: States that support the inclusion of LOB rules in their treaties are unlikely to agree a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

The AIC recommends that the characteristics of a fund which would benefit a broad exception from the LOB rule should consist of regulation relating to:

- The requirement that the fund is widely held;
- Diversification of investments or spread of risk test; and
- A published investment policy.
Q6: One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated third party financing?

The precise structuring would depend upon the type and location of the underlying assets. The intention would be to minimise the overall tax leakage by using an intermediate vehicle in a low tax jurisdiction. Alternatively, a vehicle in a higher tax jurisdiction may be used but with a higher proportion of debt funding, which may or may not be from third parties. Achieving tax neutrality between direct investment and an investment through a collective investment fund is important so as not to reduce investor returns and undermine their viability as a savings and investment product.

Q7: Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties would be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

The AIC has no comment.

Q8: The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund.” What is the meaning of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Funds”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

There is no exact definition of “institutional investor” and its meaning may vary depending on the context in which it is used. It is commonly used to refer to:

- Pension funds;
- Collective investment undertakings;
- Insurance companies;
• Banks;
• Sovereign wealth funds;
• Wealth managers;
• Local authorities.

A more narrow definition would include pension funds, collective investment undertakings and other entities which benefit from a particular tax regime in recognition of the public benefits of such vehicles.

With this narrower definition of “institutional investors”, which could include charities, institutional investors would typically benefit from tax treaties, often to the same extent as Alternative Funds. There would therefore be little incentive for such “institutional investors” to be engaged in treaty-shopping.

Q9: Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

The CIV definition is not necessarily clear because of the lack of clarity on the meaning of “regulation” and therefore the scope of the term “non-CIV” is not clear. Please see our response to Q2.

Q10: Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

The AIC recommends that if a collective investment fund meets the criteria specified in response to Question 2 then no specific anti-abuse rules should be necessary.

Q11: What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?

A “bona fide investment objective” should recognise that there should be a necessary spread of risk or diversification of assets. In the case of a master/feeder fund structures, the spread of risk requirement is met in the case of the feeder fund by the diversification of assets of the master fund.

The AIC recommends that there should be no restriction in the scope of assets that may be invested in as there are a variety of investor needs to be met.

Q12: How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?
The AIC **recommends** that there should be no large minimum investment or criteria that need to be met by a particular class of investor.

**Q13: Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical investment fund that is widely distributed?**

This varies from fund to fund. Typically, large scale closed-ended funds with publicly traded shares would be highly liquid whereas smaller funds with more unusual investment strategies would have lower liquidity but there could still be trading in such shares on a day to day basis. However, it should be borne in mind that, for many closed-ended funds with publicly traded shares, a large proportion of the shares are held by nominees, eg platforms, wealth managers, brokers, so that the beneficial ownership of such shares may change on a day to day basis but the nominee remains the same. This would mean that the investment company sees no change in the ownership of the company on its share register despite the changes to beneficial ownership.

**Q14: How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?**

The AIC **recommends** that it should not be necessary for a non-CIV to be able to identify who its beneficial owners are, provided that it meets specified criteria. It is impracticable for non-CIV to drill down to its beneficial owners and their entitlement to claim treaty benefits. Beneficial owners will be changing on a day-to-day basis, to a greater or lesser extent depending on the particular non-CIV funds, and this may not be known to the non-CIV fund.

**Q15: What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?**

For closed-ended publicly traded investment companies, where the shares are acquired on the public markets, anti-money laundering checks are carried out by intermediaries such as brokers. On a primary market issue, the investment company or its transfer agent carries out anti-money laundering checks.

For UK publicly traded investment companies there are usually no obligations under the UK-US FATCA Intergovernmental Agreement (“IGA”) as shares which are regularly traded on an established securities market are excluded from the due
diligence and reporting obligations under the terms of the IGA. They do have obligations under the CRS (see below).

The terms of the IGA agreed between Jersey and Guernsey with the US differ from the UK-US IGA. Under the terms of those IGAs, Jersey and Guernsey investment companies need to conduct due diligence in respect of and report direct holdings i.e. any holding not held by a Financial Institution acting as an intermediary.

Under the CRS, there is no exclusion for publicly traded shares of an investment company.

**Q16:** Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

The reporting under the CRS by non-CIVs may not reveal the beneficial owners of the publicly traded shares. Where shares are held through a platform or other custodian, the reporting of the beneficial owner will be done by the platform or custodian. Intermediate ownership does present obstacles to obtaining information on the ultimate beneficial owners. Given the widely held nature of non-CIVs and the frequency with which such interests are traded, it is impracticable to overcome these obstacles.

Treaty entitlement of the non-CIV should not depend upon the treaty entitlement of its beneficial owners. The AIC **recommends** that this should depend on whether the non-CIV meets certain specified criteria (see the response to Q2).

Treaty benefits of the owner of interests in the non-CIV will depend on the terms of the local treaty between the jurisdiction of residence of the non-CIV and the jurisdiction of residence of the beneficial owner of the interest in the non-CIV.

**Q17:** Since the beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple
layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

It is not necessarily true that the beneficial interests in non-CIV funds are frequently held through a chain of intermediaries whereas CIV funds are not. In any event, the treaty entitlement between each entity in an ownership chain would depend upon the terms of the relevant treaty.

Q18: The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

It would be impracticable for the treaty entitlement of the non-CIV to depend upon the treaty entitlement of its beneficial owners. The AIC recommends that entitlement should depend on whether the non-CIV meets certain specified criteria (see the response to Q2). Given the size and liquidity of some non-CIVs it would be impracticable to monitor the beneficial owners, or even 80% of them, to assess the treaty entitlement of the non-CIV.

Q19: One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by the governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn't the 50% threshold proposed for the base erosion test be too generous?

Please see the response to Q18 above.

Q20: According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

The State where the investors in the collective investment fund are resident can have anti-avoidance provisions in place to tax the proportionate share of the fund’s income which has not been distributed or reported.
Q21: As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

The treaty entitlement of a collective investment fund that meets specified criteria (see the response to Q2) should not depend upon the treaty status of beneficial owners of the collective investment funds.

Q22: The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016 (see https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-206.pdf, paragraph 4 of Article 22 “Limitation of Benefits”). Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

Having at least 95% of the aggregate vote and value of its shares owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries is so restrictive as to be unworkable.

Q23: Are there practicable ways to design a “substantial connection” approach what would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

The AIC recommends that there should be no requirement that the manager was resident in the same State as the non-CIV. This would be unduly restrictive and could impact on commercial decisions of the non-CIV to appoint the manager. This may also be contrary to EU law.

Any requirement that the treaty benefits depend on whether a certain percentage of investors are institutional is inappropriate.

The treaty entitlement of a non-CIV should depend simply on whether the non-CIV meets certain specified criteria.

Q24: Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working
Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
- What should be the consequences if, after payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirement for qualifying as a GSF or did not distribute 100% of its income on a current basis?

The GSF regime would fundamentally change the UK tax regime. It would be extremely complex and prohibitively expensive to administer. Such a proposal would not be workable.

Q25: Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

The AIC has no comment.

Q26: Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

The AIC has no comment.

Q27: Commentators who shared the concern described above in relation to the proposal for a “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released
in February 2016 (see question 22 above). If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

The AIC has no comment.

**Q28:** Please describe briefly any approach not already mentioned in this consultation document or in previous comments that would address concerns related to the way in which the new treaty provisions included in the Report on Action 6 may affect the treaty entitlement of non-CIV funds without creating opportunities for treaty-shopping or tax deferral.

The AIC has no comment.

April 2016

To discuss the issues raised in this paper please contact:

**Janette Sawden,** Tax and Legal Adviser  
janette.sawden@theaic.co.uk, 020 7282 5565
Dear Sirs

OECD public discussion draft 24 March 2016
BEPS Action 6: Treaty entitlement of non-CIV funds

The Alternative Investment Management Association\(^1\) responded to the previous OECD discussion drafts on BEPS Action 6 and now wishes to comment on the public discussion draft released on 24 March 2016 (discussion draft).

We note the terms of reference set out in the discussion draft:

> Paragraph 14 of the final version of the Report on Action 6 of the BEPS Action Plan (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) indicates that the OECD will continue to examine issues related to the treaty entitlement of non-CIV funds in order to ensure that the new treaty provisions included in the BEPS Action 6 Report address adequately the treaty entitlement of these funds.

> This consultation document has been produced as part of the follow-up work on this issue. It includes a number of specific questions related to concerns, identified in comments received on previous discussion drafts related to the BEPS Action 6 Report, as to how the new provisions included in the BEPS Action 6 Report could affect the treaty entitlement of non-CIV funds as well as to possible ways of addressing these concerns that were suggested in these comments or subsequently.

AIMA welcomes the OECD’s commitment to examine these issues further and would like to underline that this exercise should take utmost account of following basic principles:

1. collective investment vehicles (both CIV and non-CIV as defined by the OECD in this consultation) provide a means of pooling capital provided by investors;
2. this is to the benefit of society through promoting savings and to the benefit of the global economy through promoting investment; and

\(^1\) AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,600 corporate members in over 50 countries. AIMA works closely with its members to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes, and sound practice guides. Providing an extensive global network for its members, AIMA’s primary membership is drawn from the alternative investment industry whose managers pursue a wide range of sophisticated asset management strategies. AIMA’s manager members collectively manage more than $1.5 trillion in assets. AIMA is committed to developing industry skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) - the industry’s first and only specialised educational standard for alternative investment specialists. For further information, please visit AIMA’s website, [www.aima.org](http://www.aima.org).
Almost all of the questions set out in the discussion draft deal with concerns related to the LOB provision. It is a minority of jurisdictions which requires the inclusion of a LOB provision and this position is based on domestic policy considerations. Further, a recent infringement proceeding initiated by the EU Commission indicates that it may not be lawful for an EU Member State to accept a LOB provision in tax treaties to which it is party if this would be to the detriment of any resident in which a person established in another Member State holds an interest. In consequence, there may be a limited prospect of developing a LOB provision which is able to be adopted more widely.

Indeed, the EU Commission’s staff working document also established that: “the Commission considers LOB clauses to be detrimental to the Single Market and, in particular, Capital Markets Union. The more general anti-avoidance rules based on the PPT, if adopted by Member States, should be adapted to meet the requirements of a Single Market in order for them to be EU law compliant. The principle of equal treatment requires that companies owned by shareholders resident elsewhere in the EU/EEA can benefit from the same advantages derived from the Treaty as those available to companies owned by domestic shareholders”.

For a LOB provision to function with regard to non-CIV funds, three issues should be addressed:

- A LOB provision requires the identity of ultimate beneficial investors to be established. We believe that this will be difficult to achieve for many non-CIV funds (and indeed for many CIV funds as well). A test such as establishing that the non-CIV fund is widely held (and therefore unlikely to be used for a tax avoidance purpose) would be more practicable. Two issues - treaty shopping and tax deferral - have been raised as concerns which we believe can be resolved;

- With regard to treaty shopping, while the argument still stands that non-CIV funds, as with collective investment vehicles in general, are not established for tax avoidance purposes, the suggestion to grant treaty benefits in proportion to the interests of persons who are residents of the country or equivalent beneficiaries resident in other jurisdictions with equivalent double tax treaties provides a potential solution. However, it should not be a requirement that the benefits should accrue financially only to persons who would be entitled to them as direct investors – this would be difficult to ensure both administratively and because of the legal nature of fund structures, particularly if the non-CIV fund is open-ended or is a corporate entity;

2 Financing the economy - the role of alternative asset managers in the non-bank lending environment (AIMA research, 2015). AIMA has commissioned a research paper that underlines the increasing role that alternative credit funds are taking in the non-bank lending space. The increased activity from capital markets as opposed to lending through traditional bank lending channels has produced material benefits. Included among these are higher market liquidity, a greater diversity of funding sources (SMEs) and a more efficient allocation of risk among investors.

3 AIMA considers a PPT rather than a LOB provision to be the appropriate means of regulating access to treaty benefits.

4 Infringement proceeding number - 2014/4233


6 The investment fund management industry is global in terms of the location of investors, the fund management team and the portfolio investments. Consequently, the challenge for fund managers is how and where to create alternative fund structures which are able to accommodate in a cost efficient way investors from all over the world within the complex parameters of existing tax and securities laws that apply to those investors, the management team and the business or investment activities, in their multiple home jurisdictions. Factors such as administrative convenience, regulatory requirements and that some jurisdictions do not accommodate the claiming of treaty benefits through transparent structures are relevant to the access of treaty benefits and do not indicate treaty shopping. Both CIV and non-CIV funds have fiduciary and/or contractual obligations to the body of their investors which mean that a fund cannot elevate the interests of a minority of its investor base (i.e., one which may have an interest in treaty shopping) over the rest.
- Tax deferral is a threshold issue that should be addressed by countries in negotiating a tax treaty rather than a matter for the Model Treaty. Many countries have offshore funds regimes which operate in a variety of ways to ensure that investors are not able to defer taxation without incurring unfavourable tax treatment. We note that the BEPS Project decided to treat controlled foreign companies provisions (which are similar in effect) as a matter for best practice guidelines. The US passive foreign investment company (PFIC) regime and UK offshore fund rules are good examples of how domestic legislation is the appropriate instrument to address any tax deferral concerns.

AIMA considers that it remains possible to address these concerns. Failure to do so will affect the ability of non-CIV funds to operate across borders where a LOB provision operates so that investor choice will be restricted and the sources of finance to businesses will be reduced and less competitive.

The merits of non-CIV funds when promoting economic growth and capital markets, but also to facilitate the stability and efficiency of the financial services industry, have been recognised widely. Moreover, investors benefit from accessing new markets and asset classes that could otherwise be unavailable to them. In this context, AIMA would like to underline the possible unintended consequences for cross-border investment and capital flows, if the rules for tax treaty access are not appropriately calibrated and/or cannot be actually applied in practice. Whilst we support the elimination of double non-taxation, the governing principle of tax neutrality needs to have a central role (that currently it does not hold) in informing any framework that is finally agreed.

Unnecessary complexities and impractical compliance obligations applied to the alternative investment funds industry may translate into pricing volatility, and fewer investment opportunities for end-investors. It will affect the attractiveness of this type of investment pooling vehicle. Initiatives such as the EU Capital Markets Union (CMU) that are intended to rely heavily on the investment activities of non-CIV funds will be likely to be affected and consequently the broad market for finance distorted.

We have these further observations:

- The use of the term non-CIV funds suggests a uniformity to such funds which does not exist. It may be that some non-CIVs by reason of their legal form, investor base or investment strategy are more suited to compliance with a LOB provision than others;
- The proposal that a tax transparent non-CIV fund should be able to claim treaty benefits on behalf of its investors should be developed. This would offer administrative advantages to tax authorities and intermediaries as well as ensure investors receive the treaty benefits to which they are entitled, although there could be significant operating costs for investors to bear;
- The global streaming fund proposal should also be considered further. We believe it will be more appropriate for particular forms of non-CIV funds (for instance, those which are closed-ended, have a limited life, and/or hold illiquid investments) than others, unless administration programmes can be developed and used widely. It should not require distributions of income or capital gains to be made but should be able to operate on a reporting basis. It should be optional for a non-CIV fund to adopt it. However, it will require the support of a minimum number of countries prepared to introduce domestic legislation in order to be viable. Again, there could be significant operating costs for investors to bear;

7 Indeed, many investors in non-CIV funds (and increasingly the majority) are not liable to tax, such as pension funds, sovereign wealth entities, not for profit organisations, charities and other entities that would be entitled to treaty benefits in their own right if they invested directly in the underlying investments, e.g., Preqin https://www.preqin.com/docs/reports/preqin_global_investor_report_hedge_funds.pdf
8 Preventing the granting of treaty benefits in inappropriate circumstances (action 6: 2015 Final report) The new treaty provision on transparent entities that is included in Part 2 of the Report on Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements, OECD, 2015) will be beneficial for non-CIV funds that use entities that one or the two Contracting States treat as fiscally transparent since income derived through such entities that will be taxed in the hands of the investors in these entities will generally receive treaty entitlement at the level of these investors even if these investors are residents of third States. Tax neutrality in the jurisdiction where the fund is established - whether onshore or offshore - ensures that a duplication of taxation does not occur, preserving the attributes that an investor would have if investing directly in the underlying assets rather than through an alternative fund. A fund should be seen as an aggregation of capital rather than a discrete taxable entity and such characterisation underpins many of the rules allowing exemption for funds in general.
9 Non-CIV funds constitute a heterogeneous set of alternative investment vehicles, which may or may not concur in some of their features, but that are significantly diverse in nature, and with regards to the strategies pursued. I.e. whilst private equity and real state funds are generally closed-ended and therefore have a relatively stable set of investors, a hedge fund’s investor base is more frequently changing.
• Establishing full transparency for many non-CIV funds will not be practical and as many options as possible for obtaining full or partial treaty entitlement should be left open.

The annex contains responses to particular concerns and questions contained in the discussion draft.

Yours faithfully,

Paul Hale
Managing Director, Global Head of Tax Affairs
Annex - Responses to the questions in the public discussion draft

Concerns related to the LOB provision

The following questions deal with suggestions that were made in order to address the issue that the LOB provision was inappropriate for non-CIV funds with a geographically diversified base.

Suggestions that treaty benefits be granted to regulated and/or widely-held non-CIV funds

1. What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

A threshold must take account of the nature of the investors as much as their number. If investors are themselves widely-held entities, a non-CIV fund with a sufficient level of such investors should itself be considered widely-held. Some non-CIV funds such as private equity or real estate funds may have as few as ten or twenty investors, but these will be institutional in nature.

In the UK, for the purposes of the investment manager exemption (UK IME), HM Revenue & Customs applies, in the context of showing the independence of the fund and its UK investment manager, a test of a “widely-held” fund, being either that no group of five or fewer investors (and connected persons) holds more than a 50% economic interest in the fund or that no investor (and connected persons) holds more than a 20% economic interest in the fund. The fund has an 18 month grace period to meet this threshold and is deemed to continue to satisfy it while being wound up. The fund will also meet the test if it is being actively marketed with a view to becoming widely held. The test is a matter of practice rather than a statutory provision and there are other ways of demonstrating independence, some of which may include consideration of the widely-held status of ultimate investors.

This approach is also explicit in the Australian investment management regime legislation. The definition of an “IMR widely held entity” includes both specific categories of institutional investor which are deemed to be widely-held and also any other entities (typically funds) which satisfy the same test as used in the UK IME. Further, in applying that test to a fund, the participations of statutorily deemed widely-held institutional investors are excluded from consideration.

2. What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

CIVs are defined as “funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection legislation in the country in which they are established.” It is not clear what level of investor-protection legislation is required to be present.

Non-CIV funds, while possessing the defining attributes of collective investment vehicles, may not need to be subject to the same regulatory requirements as CIV funds. The regimes under which non-CIV funds are regulated for sale to “professional” or “sophisticated” investors may have few restrictions on the investments they may hold, the strategies and techniques they may adopt, or the concentration limits they must observe. In particular, private equity and other funds have the express object of acquiring controlling interests in companies. However, the investment principles set out in a non-CIV fund’s offering document may contain provisions relating to concentration of investments, restricting the ability to acquire a controlling interest in a company (or even a significant minority holding), prohibiting or restricting certain types of investments, and limiting the use of leverage which are identical to those to which a CIV fund is subject by law. Those investor principles generally cannot be changed without the consent of a majority of shareholders.

CIV funds and non-CIV funds and their managers are subject to a variety of regulatory regimes. For example, alternative fund managers operating in the EU are subject to regulation under the Alternative Investment Fund

12 And even if they are permitted to be varied in the discretion of the non-CIV fund, variation would in practice require the consent of shareholders as notice would have to be given in order not to prejudice their interests.
Managers Directive (“AIFMD”) and in the US, fund managers are subject to registration and regulation at the state level (for smaller managers) and by the Securities and Exchange Commission (SEC) for larger managers as well as by the Commodity Futures Trading Commission (CFTC). Investment funds and their managers also are subject to a wide range of securities and commodity futures laws and regulations, which govern their market conduct. Some CIV funds may fall within the scope of the same US and EU regulatory framework. On the other hand, an increasing number of alternative investment funds are UCITS products (Undertakings for the Collective Investment in Transferable Securities) that are available to retail investors as well as to sophisticated investors, in particular pension funds, and will qualify as CIV funds. The aspects of regulation identified in the question are not relevant or uniform with regard to non-CIV funds.

The preferable approach would be that a non-CIV fund should be considered “regulated” for these purposes if it is formed as a collective investment vehicle under the laws of a jurisdiction which requires the fund both to apply minimum standards of KYC due diligence in accordance with FATF and other regimes and to comply with FATCA and CRS reporting.

3. Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

In the context of a LOB, the treaty jurisdictions will have as a matter of policy a minimum participation level to be satisfied by residents of the fund jurisdiction or “equivalent beneficiaries”. It is important that the requirement on the fund to demonstrate that the level is satisfied should be administratively straightforward, such as reliance on AML and KYC due diligence and FATCA and CRS residence determinations. It may be that the Tax Relief and Compliance Enhancement (TRACE) project can be developed to enable countries to implement a system which permits intermediaries to claim treaty benefits on behalf of investors on a pooled basis, but at the same time requires the intermediaries to report beneficial owner information directly to source countries.

We do not consider treaty-shopping to be more of a concern with regard to non-CIV funds than CIV funds.

4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

This will depend upon whether the fund is an entity treated as transparent for tax purposes by the jurisdiction in which an investor is resident or whether such jurisdiction operates offshore funds legislation. Such legislation requires investors to include their share of the fund’s income in their tax returns as it arises, or with the alternative option of an unfavourable tax treatment on realisation of their interest in the fund. These regimes operate on the basis of the fund reporting income to investors without an obligation to distribute it.

This is analogous to controlled foreign companies legislation which the OECD BEPS Project regards as a matter of “best practice” for jurisdictions to adopt. It is compatible with FATCA and CRS reporting.

We note that there is no requirement in the LOB (nor need there be under applicable regulatory regimes) that CIVs should distribute their income. Investors in CIVs will often be taxed as if their share of income were distributed to them, whether or not it is distributed, while capital gains are not taxed until the investors realise their interests in the CIV.

5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

As a LOB rule by definition seeks to limit the benefit of tax treaties to persons who are residents of the fund jurisdiction or “equivalent beneficiaries”, these treaty jurisdictions will look to provisions which set a minimum threshold of qualifying investors, such as considered above. The consequence of those provisions may be to deter investment by non-CIV funds or to necessitate non-CIV funds to limit their investors by tax residence. It is important that any requirement on the non-CIV fund should be administratively straightforward. Again, reliance on AML and KYC due diligence and FATCA and CRS residence determinations may provide a solution.
We disagree that an exception for non-CIV funds that are widely-held and regulated would be more generous than an exception for publicly-listed companies, since public listing can be seen as a proxy test for those attributes.

6. One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

The aim of a non-CIV fund - as also for a CIV fund - is to ensure so far as possible tax neutrality when it invests. Any tax incurred by the non-CIV fund reduces the return to the fund and is likely to be an additional cost to investors. Therefore any intermediate structure used by a non-CIV fund will be seeking to reduce the tax liability to the lowest level imposed by the source jurisdiction. The nature of the intermediate structure and its financing will depend upon the investment being made.

Non-CIV funds set up as transparent entities

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

In such a case, the transparent non-CIV fund should be regarded (whether or not it is formed under the laws of the treaty jurisdiction or is managed there) as the representative of its investors and be entitled to make claims for the benefit of the tax treaties applicable to investors. At present it is very difficult for investors to obtain effective benefit of a tax treaty in these circumstances because the fund cannot claim on behalf of investors while the investors do not have the necessary information about the relevant investments. An administratively straightforward arrangement that would permit the non-CIV fund to claim on behalf of investors is desirable.

However, consideration has to be given also to whether this proposal would affect protection where the non-CIV fund or an entity held below the non-CIV fund needs to avail itself of treaty benefits in the context of onshore investment management giving rise to a permanent establishment.

In negotiating treaties, countries could also consider whether a CIV or non-CIV fund which is not fiscally transparent nor treated as fiscally transparent under the domestic law of the country should be able to elect to be treated as fiscally transparent.

Suggestion that certain non-CIV funds be granted treaty benefits where a large proportion of the investors in the funds would be entitled to the same or better benefits if they had received the income directly

Questions related to certain aspects of the proposal

8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

13 Additionally, the proposed amendments to the definition of a PE under BEPS 7 may increase the circumstances in which a CIV or non-CIV fund may have a PE so that restrictions on treaty access are relevant in that context also.
Institutional investors in this context are pension funds, insurance companies, charitable endowments and other bodies formed in countries with tax treaty networks which afford benefits to them. They may be largely tax exempt under the laws of their country of tax residence (such as pension funds investing for the benefit of their pensioners) or taxable (such as insurance companies investing in respect of their own marketed investment products). The category also includes sovereign wealth funds or other government agencies which may either qualify for tax treaty benefits or enjoy sovereign immunity.

The principal purpose of non-CIV funds, like collective investment vehicles generally, is to allow investors to pool capital and gain efficient access to professional management and diverse assets. Access to treaty benefits is not per se a principal purpose of non-CIV funds, although treaty benefits may be necessary to prevent investors from suffering an additional layer of tax due to their investment through a non-CIV fund. Obtaining tax neutrality is a corollary to their investment and not a main purpose of it, and is not to be regarded as treaty shopping.

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

A non-CIV fund would be, in the absence of further definition, any collective investment vehicle which is not a CIV.

CIVs are defined as “funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection legislation in the country in which they are established.” Non-CIV funds would therefore cover a spectrum from fully regulated funds that do not qualify as CIVs only because they invest wholly or to some extent in investments other than securities to alternative investment funds for “professional” or “sophisticated” investors such as real estate, private equity, private debt, venture capital, infrastructure, alternative credit and hedge funds. These non-CIV funds may be open-ended or closed-ended (with or without a fixed life), they may be companies, partnerships or other entities in legal form, and they may be tax transparent or not.

A comparison can be made with the definition of an alternative investment fund (AIF) under the AIFMD. As explained by the Financial Conduct Authority’s guidance PERG 16.2:

An AIF is a collective investment undertaking, including investment compartments of such an undertaking, which:

1. raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and
2. does not require authorisation pursuant to article 5 of the UCITS Directive.

The key elements of the definition are:

3. it is a collective investment undertaking (CIU);
4. it has a defined investment policy;
5. it raises capital with a view to investing that capital for the benefit of those investors in accordance with that policy;
6. an AIF does not include an undertaking that requires authorisation under article 5 of the UCITS Directive.

It is necessary to satisfy all the elements of the definition in order to be an AIF.

It may be considered that AIFs and non-CIV funds are for all practical purposes identical.

There is no consensus on where the distinction between CIVs and non-CIVs should lie. In particular, the qualification will clearly depend on certain criteria, e.g. the notion of widely distributed or the level of investor-protection legislation required to be present in a CIV. It must be clear how the criteria are to be applied, i.e. according to the law and regulatory system, according to the statutes of the CIV or non-CIV fund or on a factual basis. For example, a fund that is owned by a small number of investors may be deemed to be widely distributed by some countries, provided that its statutes and the law allow for the distribution to a wider number of investors and actions are not taken to restrict this. In other words, it is not the actual composition of the shareholder base that counts but the principle or the law under which the fund is established.
A real estate fund intended for retail sale will be subject to high levels of investor-protection legislation; a widely-held fund investing in a diversified portfolio of securities but with the ability to use derivatives or leverage in its investment strategy will be subject to low levels of investor-protection legislation because it is not permitted to be sold to the general public; both will be non-CIV funds.

The definition should be broad enough to include as well non-CIV funds formed as transparent entities where it may be the opaque entity owned by the non-CIV fund that would be seeking treaty benefits.

Whether it is possible to formulate a definition of non-CIV funds that would be acceptable to all countries is doubtful. We expect that particular countries will set their own parameters in negotiating tax treaties.

10. Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

These rules would address instances where, as a principal purpose, a non-CIV fund is used to obtain the benefit of a treaty which would not otherwise be available and would apply to non-CIV funds established and marketed expressly or implicitly with that purpose.

However, we question why the inclusion of anti-abuse rules should be necessary for non-CIV funds when there are none for entities qualifying under other parts of the LOB.

11. What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?

A bona fide investment objective is one which as its sole or primary purpose encompasses a coherent course of investment by the non-CIV fund and is not limited in its extent wholly or mainly to making investments which are identified by or agreed with investors with the purpose of obtaining treaty benefits that would not be available if the investors made the investment directly.

12. How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

The UK tax legislation relating to both regulated and unregulated funds including offshore funds uses in a number of contexts the concept of “genuine diversity of ownership” (GDO). This is a proxy for demonstrating that a fund is actually widely-held. It requires that a fund be intended to be, and actually is, marketed to a diverse investor base (while recognising that a narrow sector may be appropriate to a particular fund). The fund’s constitution and marketing materials must state this and it must be marketed consistently with this. This would be an appropriate model.

Questions related to identification of the investors in a non-CIV

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

This will depend upon a number of factors, not least whether the non-CIV fund is set up as “open-ended” or “closed-ended”.

In a closed-ended fund, generally no further shares or interests are issued and investors do not have the right to redeem their holdings. Unless the fund is listed and a market in its shares exists, investors will not be able readily to dispose of their holdings, and a transfer may require the consent of the fund. This structure is necessary for funds with illiquid investments, such as real estate, private equity, etc, and their investor base is accordingly largely constant.

Open-ended funds are able to issue further shares or interests and generally are required to redeem an investor’s holding at net asset value. This structure is appropriate to funds with largely liquid investments. Hedge funds are typically open-ended, though notice of redemption of a least one or three months (or longer) will usually be required and the fund may impose restrictions on redemption if it receives too many requests or cannot realise its investments in prevailing markets. Even so, ownership may be relatively stable as institutional investors have medium or long term investment horizons.
14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

The proposal would assist mainly those non-CIV funds with a stable institutional investor base. However, even in that case, a non-CIV fund may not be able to ascertain whether the investor is holding its interest in the non-CIV fund for its own account, or directly or indirectly for its own clients. Funds of funds are significant investors in many non-CIV funds, particularly those closed to new investors, as they provide indirect access to the underlying non-CIV fund. The non-CIV fund will not be able to determine what changes there are in the investors in the fund of funds and therefore may be unable to access treaty benefits.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

Under these regimes, in the absence of actual knowledge of the ultimate investor, the fund and its manager or administrator will be required, in the absence of circumstances giving rise to suspicion, only to perform due diligence back to a financial institution or other authorised person subject to a compliance obligation. The information obtained relates to the identity and tax residence of the investor and the source of the capital invested, but does not extend to whether the investor is entitled to the benefit of a particular treaty or is subject to an anti-deferral tax regime in respect of its interest in the fund.

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have if they received underlying income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

This information is not currently sufficient as it does not identify whether the ultimate investor is entitled to the benefit of the treaty (e.g. whether the investor is subject to tax as well as resident in the treaty jurisdiction) or meets other conditions (such as being subject to an anti-deferral regime or having beneficial ownership of the income within the meaning of the Indofoods case). More detailed information than is currently obtained would be required and would have to be frequently updated. While this might be addressed as a matter of contract in the subscription terms, this would not necessarily be effective in the case of an intermediate structure and enforcement would not be practical. Compliance with data protection laws would be required.

A failure to provide the information could prejudice the entitlement of the other investors in the non-CIV.

Questions related to the prevention of treaty-shopping

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

We are not clear whether this question refers to the ownership by the non-CIV fund of its investments or the ownership by an investor of its interest in the non-CIV fund. We also question whether the existence of intermediaries, such as financial advisers and platforms, is more relevant to non-CIV funds than CIV funds. However, we do not see that this is to be distinguished from the situation where an intermediate company makes a treaty claim in its own right. The same issues as to entitlement arise. The difficulty exists in identifying the ultimate beneficial owner.

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14 As the OECD has often acknowledged, bona fide commercial structures should not be considered as enabling treaty shopping. Collective investment schemes are legitimate arrangements. There is a risk that some of the current proposals will undermine tax treaty networks that are intended to facilitate international trade and promote economic growth, and which reflect widespread practices and reasonable business organisations.
18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

We assume that this proposal would apply to all non-CIV funds, whether fiscally transparent or opaque.

It is a matter for treaty jurisdictions to determine what is acceptable to them in the context of encouraging cross border investment. The measures considered in paragraph 17 (see questions 8 – 12) also address the issue.

Granting treaty benefits in proportion to the interests held by qualifying investors would ensure that no additional benefits were obtained. There should not be a requirement that the treaty benefits should accrue financially only to qualifying investors; this may be hard to achieve, both administratively and because of the legal nature of fund structures, particularly if the non-CIV fund is open-ended or is a corporate entity.

This proposal would raise other regulatory concerns, such as the prejudicial consequences for existing investors should the non-CIV fund cease to qualify for treaty benefits by reason of a change in the composition of its investor base.

19. One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

It is a matter for treaty jurisdictions to determine what is acceptable to them in the context of encouraging cross border investment, and we note that the same threshold applies to entities qualifying under other parts of the LOB which would not have to demonstrate the same level of ownership by persons entitled to treaty benefits. The measures considered in paragraph 17 (see questions 8 – 12) may also address the issue.

Questions related to the prevention of deferral

20. According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

In principle, the source jurisdiction and the fund in applying for treaty benefits would have to rely upon public information. The source jurisdiction would have to agree with its partner jurisdictions which regimes were acceptable and whether any were qualified in any way, such that additional information is required to be provided. However, this becomes administratively complex.

21. As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

It would seem to be either the ultimate beneficial owner or an intermediate entity which is subject to an appropriate level of taxation.

15 An anti-deferral regime may offer a choice between taxation of income on a current basis and deferral subject to a penal rate of taxation or a deemed interest charge on realisation.
Questions related to the new derivative benefits provision of the United States Model

22. The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016 (see https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-206.pdf, paragraph 4 of Article 22 “Limitation on Benefits”). Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

Not answered

Suggestion that the LOB should not deny benefits to a non-CIV resident of a State with which the non-CIV has a sufficiently substantial connection

23. Are there practicable ways to design a “substance connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

Not answered

Suggestion of a “global streamed fund” regime

24. Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

i. Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?

ii. Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?

iii. Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?

iv. What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

We believe that there will be classes of non-CIV funds for which a GSF regime would be attractive. This may be determined by a number of factors, including the legal structure of the non-CIV fund, its investor base, its strategy and its ability to meet the operational requirements of the regime. The type of non-CIV fund that particularly could benefit would be one that holds illiquid assets such as unlisted securities or debt, or which holds large minority positions for a long term hold strategy. For longer term buy and hold strategies, a form of GSF regime might work also.

A GSF regime should be additional to other proposed regimes for non-CIV funds.

The GSF regime should be an elective one, so that no non-CIV fund would be forced to use it. We suspect that for non-CIV funds with a diverse investor base and a higher turnover of portfolio investments, the practicalities would make it too difficult to be workable unless systems are available to match investment data to investor profiles.

Features that a GSF regime should have and areas where more work is required would include:

- a reporting rather than distributing regime would be needed
- an effective mechanism for accounting for and paying tax liabilities directly from the fund on behalf of an investor would need to be in place
- the role to be played by intermediaries in identifying treaty status of investments and investors
- whether non-CIV funds would be able to identify confidently or reliably the ultimate beneficial owner of all of their investors
• how categories of income such as amounts from derivatives, discounts on debt securities, would be treated
• whether payment of withholding taxes would be made on an annual or more frequent basis or could be deferred until an investor distribution/redemption
• practical issues including how to track the variations in each investors’ net asset value (due to the varying tax profiles), how to handle changes in applicable withholding tax rates due to an investor moving tax residence or ceasing to qualify for a particular rate under the treaty
• transitional treatment for existing non-CIV funds adopting the GSF regime and their investors
• a legislative framework will require to be developed.

**Concerns related to the PPT rule**

**Additional examples for the commentary on the PPT rule**

25. Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

Many non-CIV funds are structured on the master/feeder model or use intermediate holding companies. In applying a PPT rule, regard should be had to the overall structure of the non-CIV fund and its ownership by the ultimate investors.

**Concerns related to “anti-conduit rules”**

**Concerns with respect to conduit arrangements**

26. Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

Not answered

**Concerns related to the “special tax regimes” proposal**

**Concerns related to the “special tax regimes” proposal**

27. Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released in February 2016 (see question 22 above). If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

Not answered

**Other suggestions**

28. Please describe briefly any approach not already mentioned in this consultation document or in previous comments that could address concerns related to the way in which the new treaty provisions included in the Report on Action 6 may affect the treaty entitlement of non-CIV funds without creating opportunities for treaty-shopping or tax deferral.

We wish to raise here two issues which we believe the OECD should address.

**Securitisation companies and similar non-CIV funds**

Particular consideration needs to be given to the position of cross-border securitisation companies, collateralised loan obligation (CLO) issuers and similar non-CIV funds such as credit funds. These are
established to hold financial assets on an arm’s length basis for bona fide commercial purposes. Their treatment illustrates the difficulties inherent in the application of the LOB provision.

The securities issued by securitisation companies (generally in the form of debt instruments) are typically widely held. They are subject to various regulatory regimes (including, in an EU context, the ‘capital requirement regulations’ rules, the ‘financial vehicle corporation’ rules and the ‘credit agency regulations’).

Securitisation companies are recognised by regulators as an essential part of a well-functioning capital markets and are essential to the development of the EU Commission’s Capital Markets Union (CMU) which seeks to make finance available to small and medium-sized enterprises (SMEs) and other businesses that have seen their access restricted due to bank lending constraints. They facilitate efficient allocation of capital by investors located in different jurisdictions.

If cross-border securitisation companies were denied treaty relief, this would seriously inhibit a revival in securitisation activities. By their nature, cross-border securitisation companies will not be able to satisfy the base erosion test included in paragraph 2(e)(ii) of the LOB (as a majority of the securities issued will typically not be held by residents of the jurisdiction where the securitisation company is established).

Although it may be possible, theoretically, for cross-border securitisation companies to satisfy the derivative benefits provision in paragraph 4 of the LOB, in practical terms, it usually will not be possible for most securitisation companies to confirm who holds their securities. This is because securities issued by securitisation companies are usually listed and held in clearing systems. In those circumstances, it is impossible for the issuer to know who holds the securities and consequently would be impossible for an issuer to apply the LOB. It seems unlikely that, even if fully implemented, the TRACE project would offer a solution for securitisation companies seeking to satisfy the base erosion test where securities are held in a clearing system. Therefore, securitisation companies need to be treated in a similar way as CIVs. Otherwise, the capital markets will be unintentionally but seriously fragmented, in a situation where there is no tax mischief causing concern.

EU law

Given the CJEU rulings that directly relate to investment funds, the OECD should evaluate comprehensively the interaction of the proposed double tax treaty framework with EU law and its fundamental freedoms.

In principle, the more economic substance there is to an intermediary entity, the more likely that the creation of the establishment itself will be prima facie covered by the freedom of establishment (and equally the more abusive the structure, the less likely a fundamental freedom will be triggered). But two non-tax related cases (Centros/Uberseering) dealing with corporate forum-shopping show that just because secondary establishments lacked economic substance and were set up to circumvent company law requirements, did not necessarily mean that the freedom of establishment was withdrawn.

In the Gottardo case (C-55/2000) the Court concluded that: “With regard to a bilateral international treaty concluded between a Member State and a non-member country for the avoidance of double taxation, the Court has pointed out that, although direct taxation is a matter falling within the competence of the Member States alone, the latter may not disregard Community rules but must exercise their powers in a manner consistent with Community law”. It follows from that case law that, when giving effect to commitments assumed under international agreements, be it an agreement between Member States or an agreement between a Member State and one or more non-member countries, Member States are required, subject to the provisions of Article 307 EC, to comply with the obligations that Community law imposes on them. The fact that non-member countries, for their part, are not obliged to comply with any Community law obligation is of no relevance in this respect.

EU jurisprudence has laid down a number of justifications which must be satisfied in order to restrict a fundamental freedom. In the tax law context, those would include for instance ‘balanced allocation of taxing rights’ or ‘preventing wholly artificial arrangements’ (i.e. Cadbury Schweppes case). Collective investment vehicle structures should not be regarded as wholly artificial, but rather as commercial arrangements, set up

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16 BEPS Action 4 - Matheson, Public comments received on discussion draft on Action 4 (Interest Deductions and Other Financial Payments) of the BEPS Action Plan (page 736-742).
17 See also C-466/98 (Open Skies).
for non-tax purposes. Even if a particular collective investment vehicle structure were to be deemed wholly artificial, the restriction of a fundamental freedom would have to be justified by imperative requirements in the general interest and meet the proportionality test (Gebhard case).

Dear Sirs,

The Association of the Luxembourg Fund Industry (ALFI) is the representative body of the Luxembourg investment fund community. The Luxembourg Fund Industry is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg-domiciled investment structures are distributed on a global basis in more than 70 countries with a particular focus on Europe, Asia, Latin America and the Middle East.

ALFI is grateful for this opportunity to express its views and suggestions on this OECD Public Discussion Draft on treaty entitlement of non-CIV Funds as this question is of utmost importance for the Luxembourg investment fund industry.

ALFI position, in line with previous comments provided in relation to OECD BEPS Action 6 consultations, may be summarized as follows:

- **Definition of CIVs and non-CIVs:**

According to 2010 OECD report related to the granting of treaty benefits to CIVs, CIVs are defined as “funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection legislation in the country in which they are established.” ALFI is of the opinion that any investment vehicle which does not meet these cumulative requirements should be considered as a non-CIV fund.

1 Created in 1988, the Association today represents over 1300 Luxembourg domiciled investment funds, asset management companies and a wide range of service providers such as custodian banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax experts, auditors and accountants, specialist IT providers and communication companies.

2 OECD report dated 23 April 2010 - The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles
In order to avoid the current legal uncertainty surrounding the definition of a CIV and a non-CIVs, ALFI believes that the OECD should provide for a more detailed definition of the various terms used in this context, and in particular, of the notion of "widely distributed" or "widely held". In this respect, ALFI is of the opinion that the use of a negative control test whereby the fund may not be more than 95% owned in vote or value by less than 7 persons would be an adequate approach.

ALFI would also like to draw the attention of OECD to the fact that, in our views, the mandatory distribution requirement is more relevant in the US investment funds context rather than in an EU one. Its application varies largely from country to country even across the EU as it is only one form of tax system with no guarantee that income from the fund is actually taxed at investors' level.

- Treaty access for CIVs and non-CIVs – Application of the LOB clause

As already mentioned in its previous responses to OECD BEPS Action 6 draft discussions papers, ALFI is of the opinion that all CIVs set up as UCITS and non-CIVs with similar characteristics should automatically qualify as resident for the purpose of the application of Article 1 of the OECD Model Tax Convention and the LOB clause.

For the purpose of the application of the LOB clause to non-CIVs, the availability of relevant and sufficient documentation on the end-investors may be a key element. In our members’ experience, direct investors in the fund should be easily identified and appropriately documented while indirect investors (i.e. investing via intermediaries) may be more difficult to identify. Thus, information on investors will be gathered under FATCA, CRS or under the KYC obligations, however the individual investor information available to intermediaries responsible for these obligations is generally not shared with the non-CIV.

As mentioned in our previous responses, we are of the opinion that the proposed amendment of the OECD Model Tax Convention and the LOB provision should not be implemented without the implementation of the TRACE program. The current procedures in certain States are complex, onerous and time consuming – not in line with the constraints of CIVs and non-CIVs with indirect investors. We believe that the OECD should continue in its efforts to ensure that the TRACE program is implemented in parallel, in order to avoid having individual OECD Member States defining their own distinctive rules for the practical application of the LOB clause.

ALFI believes that a *derivative benefits rule* may also be an appropriate means to ensure that treaty benefits are appropriately granted. ALFI is of the opinion that an 80% threshold would be sufficient to avoid the risks of treaty shopping. As already mentioned, the decision to set-up non-CIVs takes in consideration various elements notably, the fact that there are appropriate resources available for analyzing, making and monitoring the investment considered. Tax considerations are not the primary concern driving the set-up of a non-CIV.
In case a “substantial connection” approach would be accepted for investment funds (either CIVs or non-CIVs), ALFI believes that it should take into consideration (i) the UCITS and AIFM context as it applies within the EU and (ii) the fact that the management of all UCITS and most Alternative Investment Funds has to comply with specific legal and regulatory obligations and requirements (such as appropriate capitalization, sufficient and experienced staff, adequate IT infrastructure, … to fulfill the legal obligations of a management company).

- **Introduction of a Principal Purpose Test (“PPT”) in the EU**

Finally, we would like to draw your attention to the fact that the European Commission has recommended the introduction of a general anti-avoidance rule (the “PPT rule”) based on a PPT (see Commission recommendation of 28.1.2016 on the implementation of measures against tax treaty abuse, hereafter “the Recommendation”). The Recommendation suggests using the template provided by the OECD but with some modifications in order to comply with EU law. The Recommendation suggests that the PPT rule will apply unless it is established that the transaction “reflects a genuine economic activity”. These terms are not further defined in the Recommendation but we understand (based on EU laws and ECJ case law) that it implies that the transaction is not wholly artificial and has valid commercial reasons.

It has always been recognized that CIVs are principally set-up for genuine commercial reasons and that, given their economic characteristics, it is reasonable to conclude that CIVs cannot be effectively used for treaty shopping. We therefore believe that the OECD (as well as the European Commission) should allow Member States to consider that all EU investment funds which are widely held, i.e. UCITS and similar non-CIVs, shall not be considered as creating opportunities for treaty shopping as (i) they are not principally used in order to obtain treaty access and (ii) they should always meet the “genuine activity” criteria. Consequently, ALFI recommends to expressly exclude these types of funds from the scope of the PPT rule. Should this approach not be retained, we recommend that the OECD should take the opportunity of the on-going work on non-CIVs to also include additional examples of bona-fide transactions where cross-border investments made via a CIV or similar non-CIVs would fall out of the scope of the PPT rule, taking into account EU law requirements.

As requested, our response to question 25 below contains suggested text for examples.

ALFI position is further detailed in the responses to the specific questions raised in the public discussion draft as follows.
I. Concerns related to the LOB provision

A. Suggestions that treaty benefits be granted to regulated and/or widely-held funds

1. What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

A number of possible approaches may be/have been used by different regulatory regimes around the world:

a) Treat funds that by nature, legal or regulatory, are “open ended” as being widely held. This is on the basis that any investor can chose to invest or disinvest in them at any moment;

b) Have a negative control test, i.e. the fund may not be more than 95% owned in vote or value by less than 7 investors (the percentage of ownership and number of investors in this approach being set by reference to the analogous “equivalent beneficiary” threshold in the LOB clause in the final BEPS Action 6 report);

c) Require a minimum part to be held by small investors, e.g. at least 15% is to be held by investors individually holding less than 2%;

d) Require a minimum number of investors, e.g. 100;

e) Some combination of the rules under points 1 to 5.

Our recommendation would be to apply rule described under b) here above as there is a certain consistency with the LOB clause.

2. What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

We consider that a fund should be considered as “regulated” when it is supervised or registered with the supervisory body of its country of residence. For the EU for example, this would include AIFs under Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (“AIFM Directive”).

In the case of Luxembourg, all entities that are subject to the agreement, registration and/or the supervision by the Commission de Surveillance du Secteur Financier (“the CSSF”) (i.e. funds that are supervised or registered with the CSSF) should come within the scope of “regulated” funds.
3. Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

ALFI believes this case would be very unlikely in practice. Should this concern was to be addressed, we would recommend that a specific rule be crafted providing that in case:

- a fund resident in jurisdiction A invests more than 75% of its assets in a single jurisdiction B, and
- the fund has been primarily marketed to one or more jurisdictions that do not have as good or better treaty benefits with B than A or the fund has reason to believe that more than 75% of the fund is held by investors in such jurisdictions,

then treaty benefits with B would no longer be available.

4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

In our experience, most large investor jurisdictions have some form of anti-deferral legislation for investments in funds, notably in Europe United Kingdom, Germany, France and Spain. Depending on the legal form of the fund and the residence state of the investor, in case of non distribution, investors may be taxable on their share in the income of the fund in the year in which the fund realizes the income or on a deemed return.

In our views, concerns about deferral are misplaced as they are a concern for the residence state not the source state. In practice, the taxation of fund income distributed or not in the hands of the investor varies widely from country to country, depending on, for example, the amount of income (minimum tax free allowances may eliminate taxation), the way the individual holds that investment (tax favored long term savings accounts or retirement accounts may allow tax reductions/ deferrals/ exemptions) and the focus on distributions or not form the fund miss the point.

We are of the opinion the requirement for mandatory distribution is just one form of tax system among many and indeed is no guarantee that the fund income is actually taxed.
5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

We believe that an appropriate combination of regulatory requirements and a widely held threshold as described above should be sufficient and would not seem to be more generous than the simplified or detailed version of the LOB.

6. One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

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B. Non-CIV funds set up as transparent entities

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

We believe the practical difficulties are operational and revolve around (i) firstly gathering the information on the residence status of each investor in order to assemble a matrix of bilateral tax treaties between each resident state and each source state and (ii) secondly, applying different procedures for each pair in that matrix, for example a source state may have different forms to apply for withholding tax relief depending on the residence state. The second part of this operational difficulty is aggravated if the investor base changes frequently, as the fund or its agents would potentially need to recalculate the exact percentage of investors in each bilateral relationship in the matrix each time a source country payment is made.

While we are aware of examples of such procedures being applied for small stable investor bases, we believe it would be very complex for a wider more changing investor base.
C. Suggestion that the LOB include a derivative benefit rule applicable to certain non-CIV funds

8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

In that context “institutional investors” should include domestic and foreign investment funds, pension funds, and sovereign wealth funds, insurance and reinsurance companies. These investors may be either taxable or not but generally are entitled to treaty benefits.

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

A non-CIV fund should be defined as any investment vehicle which does not fall within the definition of a CIV according to the OECD 2010 report “The granting of Treaty Benefits with respect to the income of Collective Investment Vehicles.”

In this report, a CIV is defined as a fund that is (i) widely held, (ii) holds a diversified portfolio of securities and (iii) is subject to investor protection regulation in the country in which it is established. Any investment vehicle which does not meet these cumulative requirements should thus be considered as a non-CIV fund.

10. Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

We believe the most realistic would be rules along the lines of those described in our response to question 1, with approach under point b. being the most practical.
11. What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?

We would propose that this be defined as being an investment objective as opposed to a typical commercial objective, i.e. an investment objective being to hold and ultimately dispose of an asset and to benefit from the income stream or capital gain on ultimate sale, as opposed to integrating the investment in a commercial operation or group where the objective is to seek commercial synergies among different members of a MNE group.

12. How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

This could be determined by the marketing strategy of fund manager, i.e. to how many investors is the fund presented.

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

While this depends on the specific non-CIV fund, as a general tendency the investments in non-CIV funds should be more stable than in CIV funds. This is because non-CIV funds are often closed-ended with investors that make commitments for the lifetime of the fund.

14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

In case of closed-ended funds, which are the large majority of non CIV funds, it should be possible to identify the investors in the fund with a high degree of accuracy. However, in case of open-ended funds, it will likely not be possible to identify the investors with the same accuracy as there may be intermediaries that invest on behalf of investors who may not be willing to share their investor base as this may be commercially sensitive.
15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

Those persons will have significant information about direct investors in the non-CIV. While accurate data about the distribution chain for non-CIV funds is not readily available, the experience of our members suggests that direct investors make up a much higher percentage of the investor base than in the case of CIVs. In the case of many non-CIVs the entire investor base is “direct”.

Those persons will have less information in relation to indirect investors, due to the operational structure of FATCA and CRS which allows intermediaries to consolidate information and handle tax compliance without sharing it with the non-CIV. The same considerations are largely true for KYC where financial intermediaries can under certain conditions rely on the KYC being performed by another intermediary.

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

In the case of direct investors, we believe the information currently available would be largely sufficient and, if required, in many cases could be supplemented at the time of investment or after. In the case of direct investors, with the exception of some widely held open ended non-CIVs, the numbers of investors tend to be smaller making any exercise of supplementing documentation more manageable.

For indirect investors, challenges do remain similar to those described in the OECD CIV report of 23 April 2010, para 18, due to the confidentiality of individual investor information. An ad hoc declaration by intermediaries of the percentage of their investors resident in each jurisdiction without disclosure of the investor name might be a solution in the case of non-CIVs that have a stable investor base.
D. Questions related to the prevention of treaty-shopping

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

19. One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

As mentioned above, we believe that the preferred approach would be to ensure that treaty access is granted to all non-CIVs which are both regulated and widely held as it should provide for the greatest level of protection against treaty abuse (due to the similarity with CIVs). But for non-CIVs which are not widely-held or regulated, we agree that a suitable solution could indeed consist in including a derivative benefits rule under which such an entity would be entitled to treaty benefits if it meets certain conditions and has a sufficiently high level of investors (e.g. 80%) who would be entitled to the same or better treaty benefits.

We consider that the proposed 80% threshold should be sufficient to actually limit the risk of treaty shopping as (i) it represents a substantial proportion of the non-CIVs investors and (ii) non-CIVs are primarily used as pooling vehicles having a defined investment strategy and investing for the benefit of their investors.

Finally, it will be important to ensure that the provision that will be retained in the LOB rule does not require that the investors are residents of the same State than the country of residence of the fund, as non-CIVs are usually held by investors of third States and are mainly distributed on a cross-border basis.

E. Questions related to the prevention of deferral

20. According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?
21. **As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?**

In the EU, investment funds are generally not subject to mandatory distributions rules. For UCITS\(^3\) for example, the EU regulatory framework only impose that the distribution policy is foreseen in the prospectus of the fund. The decision to distribute or to roll-over income is then a decision of the appropriate decision bodies of the fund. Such a decision may be influenced by a number of factors such as the nature of the income and the requirements of investors in the various countries in which a UCITS is marketed. UCITS will thus typically issue both capitalization and distribution units/shares.

For non-CIVs, many countries in Europe also do not necessarily impose mandatory distributions rules.

We understand that some governments are concerned about granting treaty benefit to non-CIVs if investors may defer recognition of income on which treaty benefits have been granted. However, we understand that not all governments share these concerns and imposing systematically an anti-deferral provision could lead to apply stricter rules from a tax perspective than the current regulatory framework existing in most countries which would create an unbalanced restriction for these States.

Furthermore, the risk of deferral should be limited in practice as (i) the investors in the non-CIVs are usually institutional investors as defined in question 8 which are tax exempt entities (such as pension funds and sovereign wealth funds) and (ii) a certain number of countries (e.g., in the EU, countries as the United Kingdom, Germany, France and Spain) already have specific domestic legislation in place according to which they tax investors on the income of funds regardless of whether the income is actually distributed.

We therefore believe that any solution that will be agreed upon in order to deal with such a policy concern should not be presented as the “primary” rule, but should rather be proposed as an alternative for countries sharing the views that the prevention of deferral must be addressed via a double tax treaty provision (and not only via a specific provision on the domestic law of each State). Adopting a stricter approach would otherwise be disproportionate compared to the effective risk of treaty abuse raised by the possible deferral.

\(^3\) Undertakings for Collective Investments in Transferable Securities ("UCITS") regulated by the UCITS Directive (Directive 2014/91/EU). UCITS are open-ended funds primarily targeted at retail investors. UCITS should be considered as “CIVs” as defined by the OECD.
F. Questions related to the new derivative benefits provision of the United States Model

22. The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016 (see https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-206.pdf, paragraph 4 of Article 22 “Limitation on Benefits”). Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

G. Suggestion that the LOB should not deny benefits to a non-CIV resident of a State with which the non-CIV has a sufficiently substantial connection

23. Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

Paragraph 3 of the LOB rule sets forth an alternative test under which a resident of a contracting state may receive treaty benefit with respect to certain items of income that are connected to the active conduct of a business in that State.

A suggestion that was made was to amend the provisions of paragraph 3 of the LOB rule in order to provide that the activities of certain non-CIV funds would be considered to constitute the active conduct of a business provided that they have a “sufficiently substantial connection” with their State of residence.

It was further suggested that such a “sufficiently substantial connection” could be based on criteria such as “the residence of members of the board of the fund or its manager/administrator, whether the board members resident in the jurisdiction have the relevant expertise to direct the business of the fund, whether the fund (or its manager/administrator) has qualified personnel in the jurisdiction that can fulfil and administer the transactions undertaken by the fund, whether decisions of the board are taken in the jurisdiction, or whether the bookkeeping of the fund is performed in the jurisdiction.”
We effectively believe that the OECD should determine specific criteria that would allow investment funds (be it CIVs or non-CIVs) to be qualified residents within the meaning of the LOB clause provided that they have a “substantial connection” with their home country, similarly to what is already foreseen for multinational corporate groups with the “active conduct of a business” test. This should moreover be done irrespective of the county of residence of their investors.

We understand that this criteria implies to demonstrate the existence of a sufficient level of substance locally and in particular that the taxpayer is conducting “substantial managerial and operational activities” (see § 47 of the commentaries on Article X as presented in BEPS Action 6 Report). Therefore, we agree that the elements listed above could be relevant in order to assess the adequate level of substance of an investment fund.

Furthermore, it should be noted that, in the EU, two sets of regulations respectively apply for CIVs and non-CIVs (i.e. respectively the UCITS Directive and the Alternative Investment Fund Managers Directive (“AIFMD”, Directive 2011/61/EU)) which provide for a certain number of rules as to the minimum substance requirements to be met by management companies of such funds. We thus consider that investment funds falling within the scope of this EU framework should be considered as having sufficient substance in their jurisdiction, as explained below in more details.

**UCITS framework**

The European Commission has issued regulations clarifying the authorisation, substance and organisational requirements that apply to management companies of UCITS, based on which these management companies must have a minimum level of substance locally. Indeed, the UCITS Implementing Directive 2010/43/EU requires UCITS management companies to:

- Employ senior management and personnel with the right skills, knowledge and experience in order to be able to fulfil their duties, and retain the necessary resources and expertise so as to effectively monitor the activities carried out by third parties.
- Put in place a sound internal organization and administrative procedures, conduct of business rules, conflicts of interest and risk management arrangements and an adequate internal control framework.

We therefore believe that the current regulatory framework applying to managers of UCITS are sufficient to consider that the fund and its manager have a sufficient “substantial connection” within the meaning of the LOB rule.

It should be noted that the UCITS Directive provides for a passport for UCITS management companies permitting UCITS funds to be managed on a cross-border basis. This means that a management company located in one Member State is permitted to manage UCITS established in other Member States. In this respect, we believe that it should also be considered that the “substantial connection” condition will also be met even if the manager operates from another EU country than the country of residence of the fund. Indeed, concluding differently would be contrary to the objectives of the EU Commission to strengthen and deepened the Single market.

4 The terms Alternative Investment Funds (“AIFs”) as used under the AIFMD refers to collective investment undertakings which raise capital from a number of investors with a view to investing it in accordance with a defined investment strategy for the benefit of those investors (and which do not qualify as UCITS). Most AIFs should be considered as “non-CIVs” as defined by the OECD.
The AIFMD has created a framework according to which AIFMs are subject to ongoing regulation and supervision. Based on the AIFMD, it is notably required that:

- An AIFM uses, at all times, adequate and appropriate human and technical resources that are necessary for the proper management of AIFs.
- The AIFM has sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing and adequate internal control mechanisms.
- The AIFM performs, at least, the following investment management functions: portfolio management and/or risk management.

We therefore believe that the conditions laid down in the AIFMD regarding the role and functions to be performed by the manager of an AIF are sufficient to consider that the AIF and its manager have a sufficient “substantial connection” within the meaning of the LOB rule.

It should be noted that the AIFMD has introduced a ‘single market framework’ which allows AIFM to ‘passport’ their services throughout the EU on the basis of a single authorization. Specifically, once an AIFM is authorised under the AIFMD in one Member State and complies with the rules of the Directive, this manager will be entitled upon notification to manage or market funds to professional investors throughout the EU. In this respect, we believe that it should also be considered that the “substantial connection” condition will also be met even if the manager operates from another EU country than the country of residence of the fund. Indeed, concluding differently would be contrary to the objectives of the EU Commission to strengthen and deepened the Single market.

H. Suggestion of a “Global Streamed Fund” regime

24. Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?

What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?
We understand that the purpose of the GSF regime is to ensure the tax neutrality of the GSF and a coherent approach among participating countries by implementing a taxation system similar to the withholding tax system applied by some EU Member States under the European Savings Directive. We however further understand that the GSF would still have to know the identity of its investors in order to determine their treaty eligibility and calculate the amount of withholding tax to be paid to the source State.

The details of the proposed tax regime have not been further explained in the discussion draft. We believe that such a proposal might be interesting to explore further, but we however have doubt as to the fact that it could bring an effective solution on a short term basis given the evident inherent complexity to implement such a proposal among various countries.

II. Concerns related to the PPT rule

25. Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

Preliminary remark

In its proposal for a recommendation on tax treaties issued on January 2016 (the “Recommendation”), the European Commission stated that Member States that will implement the commitments they have taken under BEPS in order to address their tax treaty related BEPS concerns, are advised to insert a PPT clause rather than a LOB clause. It further recommended to use the template provided for by the OECD, but with some modifications in order to comply with EU law and namely to foresee that the clause will apply unless it is established that the transaction “reflects a genuine economic activity”. These terms are not further defined in the Recommendation but we understand (based on EU laws and ECJ case law) that it implies that the transaction is not wholly artificial and has valid commercial reasons.

It has always been recognized that CIVs are principally set-up for genuine commercial reasons and that, given their economic characteristics, it is reasonable to conclude that CIVs cannot be effectively used for treaty shopping. We therefore believe that the OECD (as well as the European Commission) should allow Member States to consider that all EU investment funds which are widely held (i.e. UCITS and similar non-CIVs) shall not be considered as creating opportunities for treaty shopping as (i) they are not principally used in order to obtain treaty access and (ii) they should always meet the “genuine activity” criteria.

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Consequently, our first recommendation would be to expressly exclude these types of funds from the scope of the PPT clause. We however understand that this approach has little chance of being adopted as the OECD considers that it would be inappropriate to allow a specific group of entities to escape the application of that rule.

We therefore believe that the OECD (as well as the European Commission) should take the opportunity of the on-going work on non-CIVs to also include additional examples of bona-fide transactions where cross-border investments made via a CIV would fall out of the scope of the PPT rule, taking into account EU law requirements.

**Answer to question 25**

The examples below should be inserted in the commentaries to the PPT rule in order to ensure that transactions performed by non-CIVs will not be unduly deprived from treaty benefits.

**Example A:**

RCo, an investment vehicle resident of State R, holds and manages exclusively a portfolio of securities representing risk capital investments. RCo typically has a limited life of 10 years. Its portfolio comprises shares of ten companies resident in various States (the “Source States”), in respect of which it receives dividends and/or interests. All the companies of the portfolio have a double tax treaty with State R. RCo’s investment decisions take into account the existence of tax benefits provided under State R’s extensive tax convention network, but also various factors such as the risk profile and the expected high growth potential of the target companies, in line with the investment policy of RCo.

RCo has no obligation to annually distribute its income to its investors and may decide to reinvest its income to perform additional investments. RCo has the adequate material and human resources in State R to perform its investment activities.

The investors in RCo are institutional/professional investors who are not residents of State R and are residents of States which do not all have a tax convention with the various Source States. RCo’s investment strategy is not driven by the tax position of its investors.

In making its decision to invest in shares of companies resident of the Source States, RCo considered the existence of a benefit under the State R- Source State tax conventions with respect to dividends and interest, but this alone would not be sufficient to trigger the application of paragraph 7.

The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made.

In this example, it would not be reasonable to deny the benefit of the State R- Source State S tax treaties to RCo.
**Example B:**

Two investors, Investor A (resident in country A) and investor B (resident in country B) decide to invest together in real estate assets located in a specific geographic area. Investor A is a pension fund and Investor B has a particular expertise in managing real estate investments.

Investor A and investor B decide to set-up a joint-venture vehicle (JV) for the purpose of their investment activities, as a limited partnership in State C. JV is a tax transparent entity based on the domestic of State C.

JV decides to set-up a holding company in order to hold and manage all real estate assets that will be held directly or indirectly either via local companies in the Source States or via companies located in the same State as the holding company, and provide debt and/or equity financing to the underlying investments. The holding company is required for a number of commercial or legal reasons, e.g. in order to facilitate debt financing (including third party debt), protecting JV from loss contaminations, facilitate the JV investments and its management, facilitate the sale of underlying assets via the sale of shares in the local companies.

After a review of possible locations, JV decides to establish the holding company, RCo, in State R belonging to the same geographic area as the Source States. This decision is mainly driven by the skilled labour force, reliable legal system, business friendly environment, political stability, membership of a regional grouping, sophisticated banking industry and the comprehensive double taxation treaty network of State R.

RCo is an opaque entity which is taxable in country R. RCo has the adequate material and human resources in country R in order to perform the management and financing of its investment activities, on behalf of the JV partners.

Based on the double tax treaties between State R and the Source States, real estate income and gains held directly by RCo are taxable in the Sources States and dividend distributions from local companies benefit from reduced withholding tax rates.

As RCo is carrying out a genuine economic activity in State R, it would not be reasonable to deny the benefits of the treaties concluded between State R and the Sources States.

### III. Concerns related to “anti-conduit rules”

26. Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.
IV. Concerns related to the “special tax regimes” proposal

27. Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released in February 2016 (see question 22 above). If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

We understand that the new US proposal for a “special tax regime” will not apply to the two following situations:

“C) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person’s shareholders (with at most one year of deferral), that hold a diversified portfolio of securities, that are subject to investor-protection regulation in the Contracting State and the interests in which are marketed primarily to retail investors; or

D) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person’s shareholders (with at most one year of deferral) and that hold predominantly real estate assets; (…)"

We appreciate the fact that a carve-out has been inserted for certain types of investment funds. However, the wording of this proposal triggers the following concerns:

- Paragraph c) above provides for a carve-out for CIVs. However, the definition retained is not exactly identical to the definition of the OECD 2010 Report. Indeed, based on such a report, CIVs are defined as funds “that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established”. Thus, there is no reference made to a maximum period of deferral of taxation, contrary to the US definition. We believe that such condition should not be maintained in the final report and that it should be ensured that the definition of CIV is consistent in all sections of the BEPS 6 Report / OECD Model Convention.

- Paragraph d) above provides for a carve-out for certain vehicles that hold predominantly real estate assets (i.e., REITs). We however wonder why the carve-out has not been extended to all non-CIVs. Indeed, special tax regimes granted to non-CIVs in their home country only aim at ensuring the tax neutrality between a direct and an indirect investment and we see no valid reason for excluding non-CIVs from the carve-out granted to CIVs and to REITs. Non-CIVs should therefore be added to the list of entities which are not targeted by this rule. Furthermore, States should have the possibility to clarify which type of investment fund will actually benefit from such a carve-out, by adding an exhaustive list during their bilateral negotiations.

Finally, and more generally, we do not see what the benefit of the introduction of such a rule is as the LOB and PPT rules should already provide for sufficient safeguard in this respect.
V. Other suggestions

28. Please describe briefly any approach not already mentioned in this consultation document or in previous comments that could address concerns related to the way in which the new treaty provisions included in the Report on Action 6 may affect the treaty entitlement of non-CIV funds without creating opportunities for treaty-shopping or tax deferral.

As mentioned above, we believe that the particular situation of European investment funds should be taken into account when designing the rules that will be incorporated into the OECD Model Convention.

This is important in order to ensure that the rules will comply with EU law requirements and avoid possible challenges of the provisions of tax treaties at a later stage. We refer in this respect, as a concrete example, to the infringement procedure which has been launched recently by the EU commission against the Netherlands with respect to the incompatibility of the LOB in the current Netherlands-Japan tax treaty.

This is also key in order to ensure that the tax framework that will apply to European investment funds is coherent and in line with the current European regulatory framework. This means that the new rules that will be agreed upon under the BEPS Action 6 Report must not be more restrictive than what is currently foreseen under the EU regulations. As the rules contained in the BEPS 6 Report are today largely build on US requirements, it will necessarily require some adjustments to take into account EU constraints and specificities. This would otherwise increase the risk of creating new tax barriers to cross-border investments and would be contrary to the goal of the EU Commission to enhance the Single Market. Indeed, as recently stated by the European Commission in its action plan to achieve a true single market for capital in Europe, “We need to identify and remove the barriers which stand between investors' money and investment opportunities, and overcome the obstacles which prevent businesses from reaching investors. We also need to make our system for channeling those funds – the investment chain – as efficient as possible, both nationally and across borders” and “The Commission will gather evidence on the main barriers to the cross-border distribution of investment funds. This would include in particular disproportionate marketing requirements, fees, and other administrative arrangements imposed by host countries and the tax environment. Based on the evidence provided, the Commission will seek to eliminate key barriers, through legislative means if necessary”.

Consequently, the OECD should include comments in the BEPS Action 6 Report that allow EU Member States to take these considerations into account. This means, for example, that when any conditions with respect to the country of residence of investors are foreseen, EU Member States should be encouraged to use any alternative wording according to which the country of residence of the investors is irrelevant, as long as they are resident within the EU/EEA.

We are grateful in advance for your attention to the comments expressed in this letter and we welcome the opportunity to discuss these with you.

Should you need any additional information, ALFI would be pleased to assist you.

Kind regards,

ALFI
22 April 2016

Sent via email: taxtreaties@oecd.org

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Dear sir / madam:

The Asset Management Group (the “AMG”) of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to respond to the Organisation for Economic Co-operation and Development (the “OECD”) on questions included in its recent consultation document on the treaty entitlement of non-CIV funds (the “Discussion Draft”). Specifically, this letter addresses those questions relating to: (i) non-CIV funds set up as transparent entities; (ii) the suggestion that the limitation on benefits include a derivative benefit rule applicable to certain non-CIV funds; (iii) the suggestion that a “Substantial Connection” approach be adopted; and (iv) the suggestion of a “Global Streamed Fund” regime.

I. INTRODUCTION

SIFMA AMG is concerned that investors in non-CIV funds may often be denied treaty benefits under the currently proposed principal purposes test (the “PPT”) and limitation on benefits (“LOB”) provisions. These investors would be denied such benefits that they otherwise would have been entitled to had they invested directly rather than through such funds. In recognition of this concern, the Discussion Draft provides that pension funds will be entitled to treaty benefits, which will be reflected in upcoming changes to the OECD Model Tax Convention. SIFMA AMG supports this change, and further supports permitting the entitlement of treaty benefits to the other types of non-CIV funds as well.

1 The AMG is the voice for the buy side within the securities industry and broader financial markets, which serves millions of individuals and institutional investors as they save for retirement, education, emergencies, and other investment needs and goals. The AMG’s members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. SIFMA AMG is comprised of over fifty members – the list of members is available at: http://www.sifma.org/amg-member-directory/. The clients of AMG member firms include, among others, registered investment companies, separate accounts, ERISA plans, and state and local government pension funds.

2 A “non-CIV”, or “non-collective investment vehicle”, is defined as an investment vehicle that does not qualify as a “collective investment vehicle” within the meaning of the 2010 OECD Report, The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles. “Collective investment vehicles” is defined therein as being limited to “funds that are widely-held, hold a diversified portfolio of securities, and are subject to investor-protection regulation in the country in which they are established.”
For investors, access to treaty benefits is important for purposes of avoiding an additional layer of tax, but it is not the principal purpose of non-CIV funds. Rather, non-CIV funds provide vital sources of capital to fund various economic activities around the world. Non-CIV funds provide investors with access to additional capital markets that provide opportunities to diversify risk and seek increased returns. Non-CIV funds also provide access to capital for diverse asset types including small- and medium-sized enterprise funding, private equity, and non-publicly issued debt, among others.

When considering the various types of assets mentioned above and the inclusion of all funds that are not CIVs (as defined in footnote 2), non-CIV funds are quite diverse in terms of the structure, number and types of investors, investment mandate (regarding asset classes and jurisdiction), and commercial structure (i.e., whether the fund is open-ended or closed-ended). The diversity and complexity of non-CIV funds increase as the number of cross-border investments increase as well. Moreover, the investments are pooled from investors in different countries. This convergence of events raises the question of which bilateral income tax treaty applies and whether treaty benefits should be granted.

II. OBJECTIVE

Investors in non-CIV funds who are entitled to treaty benefits on a direct basis should receive those treaty benefits notwithstanding their investment in a pooled vehicle. Many investors in non-CIVs, however, are concerned that they are losing treaty benefits that they would have received if they invested directly. Investors are seeking reassurances that non-CIV funds will cope in the future world and are raising questions about the tax assumptions within pricing models used to evaluate investments. A reduction in investor activity in non-CIV funds will negatively impact the economies of source countries by reducing the number of investment opportunities. It is important that there is a workable solution that recognizes entitlement of treaty benefits for non-CIV funds.

At the same time, SIFMA AMG recognizes there are two general concerns about granting treaty benefits with respect to non-CIVs: (i) non-CIVs may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits; and (ii) investors may defer recognition of income on which treaty benefits have been granted. Accordingly, we support a solution that results in a “principled” outcome that acknowledges these concerns while maintaining the important role that non-CIVs play in the global economy.

III. DISCUSSION

SIFMA AMG believes that the Discussion Draft correctly identifies two basic approaches to granting treaty benefits to non-CIV funds. The first approach is granting treaty benefits directly to the fund based on its own characteristics, and the second approach is granting treaty benefits based on the treaty benefits that the investors would have received if they invested directly. Notwithstanding the viability of the first approach, SIFMA AMG believes that there is a growing acceptance within the industry that any solution to granting treaty benefits will be through a proportional approach that involves investor identification (i.e., the second approach).

The solution should balance the policy concerns of the governments and need for operability. Under the first approach, the source country’s policy concerns about treaty shopping may not be satisfied by a mere reference to whether the fund is regulated or widely held, whereas under the second approach, the need for operability may be hindered by an unwieldy investor identification process. The framework for CIVs that are not widely held should permit such investment funds to receive treaty benefits, under either approach, to the extent that ultimate investors in a fund would be entitled to treaty benefits if they had invested directly in capital markets, rather than through a pooled investment fund. SIFMA AMG believes that if governments provide clear and reasonable rules defining the documentation required to allow for treaty
benefits, non-CIV funds would implement the systems and procedures to collect such documentation. After documentation, a wide range of principled solutions become possible based on either of the approaches.

Below are our responses to the questions raised in the Discussion Draft relating to the granting of treaty benefits for non-CIV funds.

a. **Transparent Non-CIV Fund Entities (Discussion Draft Question 7)**

The Discussion Draft describes the new treaty provisions on transparent entities that was included in Part 2 of the Report on Action 2, Neutralising the Effects of Hybrid Mismatch Arrangements. Applicable in this context, the provisions would ensure, for example, that treaty benefits are available to an investor in a non-CIV fund so long as the non-CIV fund is treated as transparent. To this effect, the Discussion Draft asks questions about practical difficulties of the application where an entity with a wide investor base is treated as fiscally transparent under the domestic laws of a State that entered into tax treaties.

SIFMA AMG notes that many funds in the U.S., some with a large investor base, are currently designed to be fiscally transparent. But as capital markets expand, funds are becoming increasingly complex due to the growing number of investors from multiple jurisdictions and due to the funds themselves investing in multiple jurisdictions. Despite being treated as fiscally transparent in the U.S., there is no worldwide recognition of this classification. As such, any solution addressing cross-border transactions would require all jurisdictions to allow funds to be treated as transparent. The consequence of non-conformity would lead to treaty-shopping.

The coordination of jurisdictions would be required on multiple fronts. This includes standardization and coordination of documentation, withholding rules, tax transparency treatment, standard accounting and reporting systems. Additionally, an end-to-end data flow from investments to the ultimate investors would be needed because fund of fund structures would no longer be effective. SIFMA AMG believes that this is possible in theory, but if the governments of various jurisdictions are ready to consider such coordination, we encourage the OECD to further examine the Global Streamed Fund regime to support such an initiative (discussed in Part III.d.).

b. **Derivative Benefit Rule (Discussion Draft Questions 8 to 21)**

The Discussion Draft contains questions on the suggestion that the LOB include a derivative benefit rule applicable to certain non-CIVs. Among the questions are those relating to: (i) aspects of the proposal; (ii) the identification of the investors in a non-CIV, (iii) the prevention of treaty-shopping, and (iv) the prevention of deferral. Select questions are addressed below.

i. **Proposal Aspect (Discussion Draft Questions 8, 9)**

With respect to question 8 regarding “institutional investors”, that term generally refers to pension funds, sovereign wealth funds, banks, and insurance companies. However, the use of a definition of “institutional investors” that identifies a class of investors eligible for treaty benefits may not be helpful because of the wide range of entities and structures that exist amongst the general understanding of the term “institutional investors.” Thus, in order to accurately define “institutional investors” source countries would have to create a broad definition of this term. An expanded definition of “institutional investors” may, however, lead to treaty shopping by those entities that should not be entitled to treaty benefits.
With respect to question 9 regarding the term “non-CIV”, similar to question 8, SIFMA AMG does not believe that a narrower definition than the one provided in the 2010 OECD report on CIVs is needed. Because non-CIV funds cover the breadth of asset classes, and vary with respect to their structure, number and types of investors, different solutions are likely needed to address the various issues presented. The solution should generally include treaty benefits for all types of managed funds, such as those investing in real estate (infrastructure, real estate including social housing for example), unlisted companies (private equity funds, venture capital funds, loan origination funds), and hedge funds. Governments could take preferred actions with respect to personal holding companies and trusts.

ii. Investor Identification (Discussion Draft Questions 13, 14, 15, 16)

With respect to question 13 regarding ownership of interests in non-CIV funds, the stability of ownership varies. There are certain non-CIV funds that invest in infrastructure and real estate where the ownership is fairly stable – these are typically closed-end funds and provide a longer stable investment. Alternatively, there are certain non-CIV funds where ownership is constantly changing.

With respect to question 14 regarding ultimate beneficial ownership, a non-CIV fund should be aware of the investor’s identification when there is direct investment in a non-intermediated manner. While the investor itself may be a complex organization, so long as the entity making the investment is eligible for treaty benefits, that should suffice for purposes of treaty benefits. Where the investment is made through an intermediary or other similar manner, there will be someone in the chain of intermediation who is aware of the ultimate beneficial ownership’s identity. Investors in many alternative investment funds hold their interests directly rather than holding “in street name”. Further, regulatory requirements, including know your customer rules, U.S. FATCA and UK CDOT, require fund managers to gather and information about their investors. To the extent investment funds have intermediary investors, such as funds of funds or bank-sponsored funds, those intermediary investors can conduct similar diligence on their investors to provide representations or certifications to the investment fund seeking proportional treaty benefits. We note that other tax frameworks, including U.S. FATCA and UK CDOT recognize that investor certifications are an important mechanism for investment funds and other entities to be able to use as part of their diligence process.

With respect to questions 15 and 16 regarding the type of information, while there is certain information available under anti-money laundering, U.S. FATCA, and the common reporting standard rules, additional information or documentation may be needed for purposes of determining treaty benefits eligibility. The information generally provided in the above-mentioned documentation includes name, jurisdiction(s), residence and taxpayer identification numbers. The jurisdiction information is essential to establishing treaty benefits eligibility, but there may be additional information required. SIFMA AMG encourages adopting the self-certification system developed in TRACE as a mechanism to demonstrate the appropriate information to tax authorities. However, we encourage the OECD to provide individual jurisdictions to adopt alternative approaches that would accomplish the same goal, to ensure that the ability to obtain treaty benefits is not entirely dependent on implementation of TRACE.

iii. Treaty-Shopping Prevention (Discussion Draft Questions 17)

With respect to question 17 regarding intermediary chains, SIFMA AMG believes documentation and reporting could be implemented to identify the ultimate investor, similar to U.S. FATCA, the common reporting standard, and the qualified intermediary system in the U.S. The qualified intermediary system provides for certifications, or lack thereof, to identify the residence of investors.
With respect to question 18 regarding certain thresholds for granting full benefits to a non-CIV fund, SIFMA AMG believes that the percentage rate is a balance between the administrability concerns and the perceived risk to government policy concerns. For example, requiring a 100 percent threshold would render funds to be cost-prohibitive to investors and ultimately reduce cross-border investments. At the other end of the spectrum, having no threshold requirement would lead to treaty shopping. The percentage threshold determination would be adjusted up and down to address the level of concern to a particular jurisdiction. Proportionate benefits could also be considered to address such concerns. Such benefits would be in line with what the investors would have received had they invested directly. This would be particularly difficult for fund of fund structures.

iv. Deferral Prevention (Discussion Draft Questions 20, 21)

With respect to question 20 regarding income deferral, it may be difficult for source countries to determine whether investors have included their proportionate share of fund income. Many non-CIVs distribute cash to investors and generate a greater return on investment when dispositions are made. Furthermore, investors often want cash because they are either tax exempt—so deferral is not an incentive—or they do not want to recognize phantom income and the resulting tax liability. While the distribution is within a degree of control of the non-CIV funds, investors may establish intermediate holding entities (that are eligible for treaty benefits) to secure the deferral of taxable income. In this respect, governments should seek to define anti-deferral regimes that address funds.

SIFMA AMG believes that concerns about deferral of income are best addressed by the investors’ country of residence through anti-deferral rules such as the U.S. passive foreign investment company (“PFIC”) framework or the UK reporting fund framework.

Under U.S. tax rules, foreign investment funds are generally deemed a PFIC. A PFIC is a foreign corporation where at least 75 percent of its gross income is passive income, or where the average percentage of its assets which produce passive income (or which are held for the purpose of producing passive income) is at least 50 percent. Direct and indirect U.S. shareholders of a PFIC are all subject to PFIC rules and are subject to U.S. tax as set out in the rules. However, these shareholders may elect to be treated as shareholders of a qualified electing fund (“QEF”), which subjects the shareholder to an anti-deferral regime that is a modification of the “pure” PFIC regime. We believe the U.S. PFIC regime, and in particular, the U.S. QEF PFIC regime, provides an example of an anti-deferral framework that addresses policy concerns regarding investor deferral of income. SIFMA AMG would urge the coordination of a regime that allows for compliance and administrability that do not pose prohibitive burdens on the non-CIV funds.

With respect to question 21 regarding indirect ownership, whoever is claiming the treaty benefit will be tested. Thus, beneficiary would be the one entitled to the equivalent treaty benefits under the derivative benefits proposal. This would typically be determined at the first entity not treated as transparent.

c. Substantial Connection Approach (Discussion Draft Question 23)

The Discussion Draft highlights a suggested amendment to the LOB rule allowing certain non-CIV funds that are considered to constitute the active conduct of a business to be eligible for treaty benefits with respect to the income derived in connection with such conduct. If the fund has a “sufficiently substantial connection” with its State of residence, then the income would be eligible. The potential criteria for determining “substantial connection” included, among other things, the residence of board members or managers and administrators, whether the board members residing in the jurisdiction
have the relevant expertise to direct the fund’s business, and whether the managers and administrators have qualified personnel in the jurisdiction to carry out the fund’s transactions.

However, the Discussion Draft notes that Working Party 1 dismissed the “substantial connection” approach in the context of the LOB rule due to treaty shopping and tax deferral concerns, and the Discussion Draft further asks whether there is a practicable way to designing such an approach without raising these concerns.

In light of Working Party 1’s hesitance to further consider the “substantial connection” approach in the context of the LOB rule, SIFMA AMG supports the consideration of the “substantial connection” approach in the context of the PPT: Where there are considerable non-tax commercial reasons for establishing the fund and its activities have a substantial connection to the State of residence, these non-CIV funds should be entitled to treaty benefits.

As stated in Part I, the principal purpose of non-CIV funds is not to obtain treaty benefits. In deciding on where to establish a fund’s jurisdiction, the fund manager looks at many commercial considerations: (i) political stability, and the regulatory and legal system; (ii) legal flexibility and simplicity, particularly to facilitate co-investments; (iii) flexibility to extract exit proceeds from sales of the portfolio; (iv) access to personnel like directors with regional investment expertise and knowledge, and (v) certainty of taxation of the holding company at the end of investment. When these considerations are factored into determining “substantial connection,” the PPT would deny fewer legitimate entitlements of treaty benefits.

d. Global Streamed Fund Regime (Discussion Draft Question 24)

The Discussion Draft highlights a recent suggestion and questions the suggestion of a “Global Streamed Fund” (“GSF”) regime, an international regime that would permit treaty benefits for certain qualifying funds. The regime would be implemented through the adoption of uniform domestic laws allowing a fund to elect, regardless of its legal form, to be treated as a GSF. Similar to Working Party 1, SIFMA AMG has not yet fully examined the GSF regime. Nonetheless, we support the further discussion of the GSF regime, which looks like an innovative and pragmatic approach to address country concerns around investor identity and treaty entitlement while providing a means for non-CIVs to continue to be a viable means of cross-border investment. We encourage Working Party 1 (or the formation of a sub-working group) to further address the relevant issues and to successfully design such a regime.

* * *

3 Additionally, certain OECD member countries have signaled that they are not in favor of a “substantial connection” approach in determining treaty benefits entitlement under the LOB rule.
SIFMA AMG sincerely appreciates the opportunity to send our responses and your consideration of these views. We stand ready to provide additional information or assistance that the OECD might find useful. Please do not hesitate to contact either Timothy Cameron at (202) 962.7447 or tcameron@sifma.org, or Lindsey Keljo at (202) 962.7312 or lkeljo@sifma.org with any questions.

Sincerely,

Timothy W. Cameron, Esq.
Asset Management Group – Head
Securities Industry and Financial Markets Association

Lindsey Weber Keljo, Esq.
Asset Management Group - Vice President and Assistant General Counsel
Securities Industry and Financial Markets Association
Dear Sir/Madam

**OECD consultation: Treaty entitlement of non-CIV funds**

The Association of Real Estate Funds (AREF) welcomes the opportunity to respond to the OECD’s consultation on the treaty entitlement of non-CIV funds.

A critical feature of any fund is that it secures for its investors the same, or substantially the same, tax treatment as direct investment. This feature was recognised by the OECD in its 2010 report ‘The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles’. It is therefore essential that non-CIV funds and/or their investors are able to benefit from treaty entitlement; without it tax neutrality would be lost. However, we understand the OECD’s concerns in relation to treaty shopping and deferral of the taxation of income.

According to the OECD’s 2010 report, the term CIV means a fund which is widely-held, holds a diversified portfolio of securities and is subject to investor-protection regulation in the country in which it is established. A non-CIV fund should be a fund which fails at least one of these three conditions. We consider that it would be helpful to re-visit the definition of CIV. For example, it seems odd to determine whether or not a fund is a CIV based on the asset class in which it invests. As it currently stands, real estate funds cannot be CIVs as they invest in the wrong type of asset. We consider that it should be possible for a real estate fund to be a CIV. However, it would not be essential for the Model Tax Convention and Commentary fully to define all terms. For example, it may be preferable and/or simpler for the States involved in bilateral treaty negotiations to specify the meaning of regulated.

We do not consider a broad exception from the LOB rule on the basis that a fund is widely-held or regulated to be the best approach.

For most real estate funds, it should be possible to identify the ultimate investors. Treaty entitlement determined on the basis of investor eligibility would seem a good option, although its administration would need careful thought. We support the LOB including a derivative benefit rule as a pragmatic approach. If there were a need to identify and assess the status of every investor for treaty entitlement, being unable to gather this information for a single investor would adversely affect all investors in the fund.
Almost all, if not all, treaties give taxing rights over income from real estate to the State in which the real estate is situated. This means that tax is levied at the fund level for a real estate fund, so deferral of tax may be less or a concern than for other types of fund.

In the appendix, we respond to the consultation questions of particular relevance to property funds. We would welcome the opportunity to discuss the impact of the consultation proposals on property funds in more detail.

I am available at your convenience to discuss anything in this letter.

Yours faithfully

John Cartwright
Chief Executive
The Association of Real Estate Funds
APPENDIX

SUGGESTION THAT TREATY BENEFITS BE GRANTED TO REGULATED AND/OR WIDELY HELD NON-CIV FUNDS

Question 1: What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

Question 2: What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

Question 3: Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

It should be possible to classify a fund either as a CIV or as a non-CIV. According to the OECD’s 2010 report, a CIV is a fund which is widely-held, holds a diversified portfolio of securities and is subject to investor-protection regulation in the country in which it is established. A non-CIV should be a fund which fails at least one of these three conditions.

In the context of CIVs, the purpose of the widely held concept is to help overcome otherwise insurmountable problems with identifying and establishing treaty eligibility of the many diverse investors of a fund that is broadly distributed to a retail market. In contrast, for most real estate funds, it should be possible to identify the ultimate investors. Treaty eligibility on the basis of investor entitlement would seem a better option, although dealing with this from an administrative point of view would need careful consideration.

Question 4: Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

Almost all, if not all, treaties give taxing rights over income from real estate to the State in which the real estate is situated. This means that tax is levied at the fund level for a real estate fund, so deferral of tax may be less or a concern than for other types of fund.

In relation to offshore funds, including real estate funds, UK investors are subject to tax on income of the fund regardless of whether distributions are made. Some other jurisdictions have similar rules.
For a real estate fund, mandatory distribution of either property income or capital gains would be undesirable. This is because there is a regular need to maintain and invest in existing real estate assets.

**Question 5:** States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

As explained in our answer to questions 1 – 3, we do not consider a broad exception from the LOB rule on the basis that a fund is widely-held or regulated to be the best approach.

**NON-CIV FUNDS SET UP AS TRANSPARENT ENTITIES**

**Question 7:** Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

We support the suggestion that a non-CIV be able to elect to be treated as fiscally transparent, but that it is a matter of domestic law and not an option to be made available via treaties themselves.

For example, the UK PAIF regime is elective. Although a PAIF is not transparent as such (it takes corporate form), only the investors are taxed on property business profits. The fund is exempt.

In the context of most real estate funds it is usually possible to identify the investors. The existence of money laundering rules and the introduction of automatic exchange of information provisions assist in this but may not be a complete solution. For example, CRS procedures only require consideration of the immediate investor whereas it is necessary to examine the ultimate investor for the purpose of treaty access.

It is also important to note that problems accessing treaty benefits are often due to a gap between requirements of the source State and information which it is possible to provide from the State of residence. Global co-ordination of documentation requirements would assist with this.

**SUGGESTION THAT THE LOB INCLUDE A DERIVATIVE BENEFIT RULE APPLICABLE TO CERTAIN NON-CIV FUNDS**

**Questions related to certain aspects of the proposal**

**Question 9:** Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?
As discussed in the introduction and in our answers to questions 1 – 3, a non-CIV should be a fund which is not a CIV (as defined in the OECD’s 2010 report).

**Questions related to the identification of the investors in a non-CIV**

**Question 13: Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?**

A closed-ended real estate fund typically has a fixed life and a stable investor base. In comparison, an open-ended real estate fund is typically long-term in nature and so has a higher frequency of changes in investors.

**Question 14: How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?**

For real estate funds, it should be possible to identify the ultimate investors. Treaty eligibility on the basis of investor eligibility would seem a good option, although dealing with this from an administrative point of view would need careful consideration.

However, we support the LOB including a derivative benefit rule. This would a pragmatic option and significantly ease the burden on the fund manager. If there were a need to identify and assess the status of every single investor for treaty access, being unable to gather this information for a single investor would adversely affect all investors in the fund.

In practice problems accessing treaty benefits are often due to a gap between requirements of the source State and information which it is possible to provide from the State of residence. Global co-ordination of documentation requirements and/ guidance would assist with this.

**Question 17: Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?**

Almost all, if not all, treaties give taxing rights over income from real estate to the state in which the real estate is situated. This means that tax is levied at the fund level for a real estate fund, so non-taxation of intermediaries is not a particular concern.
Bundesverband Alternative Investments e.V. (BAI) is the cross-asset and cross-product advocacy association for the Alternative Investments industry in Germany. Our 160 member undertakings sponsor, manage, administrate or provide professional services for the entire range of open- and closed-ended domestic and EU or foreign alternative investment funds: infrastructure, private equity funds, private debt funds, absolute return funds, multi-asset funds, etc.

Our members and their institutional investor base (insurance companies, pension funds, occupational pension schemes, endowments, etc.) are directly and significantly affected by the various OECD initiatives and accompanying national legislation.

BAI welcomes the opportunity to submit its comments to the OECD BEPS consultation document on the treaty entitlement of non-CIV funds.

A) Introductory remark

1. Brief introduction of the envisaged new German Investment Taxation Act (GITA)

We appreciate and acknowledge the efforts undertaken by the OCED in the context of the BEPS project. One aspect we support explicitly is the idea of enhanced transparency. Thus, BAI advocated and still advocates for enhanced transparency also with regard to the fundamental reform of the German investment fund taxation regime, the German Investment Taxation Act (GITA; Investmentsteuergesetz).

The German government is currently undertaking to introduce a new investment taxation regime (entering into force on January 1st, 2018) applying to all UCITS funds subject to the UCITS directive and all AIFs subject to AIFMD as well as certain other investment vehicles.
BAI believes that it is crucial to briefly refer to this reform act as it is due to be adopted in a short period of time and we see a lot of discrepancies to ideas and concepts developed by the OECD, which of course have relevance with regard to this consultation, too.

As mentioned above the proposed new GITA will apply to all UCITS funds subject to the UCITS directive and all AIFs subject to AIFMD as well as certain other investment vehicles. The only exception will be partnerships that are not UCITS (e.g. private equity funds or infrastructure funds). For these partnerships, the general rules on the taxation of partnerships will continue to apply.

The fundamental change to the current regime is the introduction of a non-tax-transparent regime for basically all investment funds unless they qualify as a so-called specialized investment fund (SpezialInvestmentfonds). Only the latter can opt for the traditional transparent taxation regime. The following scheme shows the distinction between specialized investment funds and other investment funds:

Of course, all requirements for a specialized investment fund have to be fulfilled accumulative and in addition, the list of eligible assets is very much restricted; these assets are securities, money market instruments, derivatives, cash, real estate, real estate companies, units in UCITS, units in other specialized investment funds, shares in PPP, precious metals, non-secured loans, and shares in non-listed corporations.
Considering this list, it becomes obvious that in general only typical UCITS can qualify as specialized investment funds. At once individual are prohibited to invest in these funds. Specialized investment funds are only investable for institutional investors.

If any of these criteria for specialized investment funds is not met the fund is subject to the intransparent taxation regime which functions as follows: the investment funds’ income from domestic sources will be subject to corporate income tax; second an investor’s allocable share of income derived from an investment fund will be subject to taxation regardless of the sources of the relevant proceeds.

This brief introduction in the envisaged GITA shows that there are still so many discrepancies between national (investment) taxation and ideas and concepts developed by the OECD. Whereas the OECD advocates for more transparency Germany is on its’ way to switch into an intransparent taxation regime and offering transparent taxation only under very exceptional circumstances which are questionable and discriminatory. In particular the over-arching principle of facilitating tax neutrality for an investor (i.e. structures are designed to provide investors with neutral tax outcomes whether they invest directly or through a fund) is put into question by the German government and on the way to be abolished.

BAI is very much concerned as OECD principals and guidance will lead i.a. to new tests which have to be satisfied in order to obtain treaty benefits, in addition further investor level information may be required, however, for the moment it appears that the envisaged GITA will not be able to align with those requirements.

2. General concerns and areas of ambiguity

One difficulty in responding to this consultation is that there is still too much unclarity how the term “non-CIV funds” might be finally defined. At the same time it is difficult to understand why the current definition of CIV is so narrow, being limited e.g. to investments in securities but not in other assets.

Nevertheless the general concept of treaty entitlement of funds (CIVs and non-CIVs) has been discussed now for a long time without a clear and agreed definition so there is lots of ambiguity which makes it now very difficult to cover adequately in the questions posed the very heterogeneous segment of the entire range of non-CIV funds and to display every aspect in each single question.

Therefore and once again, it is crucial to highlight that AIFs are not in the business of treaty shopping. The primary purpose of these funds is the acknowledged business purpose of pooling capital for the benefit of the entirety of investors.
BAI also regrets that the Treaty Abuse Report left open the best means of addressing treaty eligibility for Collective Investment Vehicles (CIVs) and ‘non-CIV funds’, which are very prevalent across the asset management industry.

We do not see a benefit of limiting the definition of CIVs to “funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection legislation in the country in which they are established.” This definition generally includes only regulated investment funds such as UCITS or Mutual Funds. On the other hand, other funds such as AIFs, REITS, etc. are likely to be considered “non-CIV funds”, however, it remains unclear how this heterogeneous segment of “non-CIV funds” will be treated and further segmented.

Reverse to the definition of a CIV a non-CIV fund would be, in the absence of further definition, any collective investment scheme, which is not a CIV.

Non-CIV funds would therefore cover a very broad spectrum of funds:

- funds having limited number of investors, or
- funds having limited number of assets and/or assets other than securities, or
- funds having no specific investor protection legislation; or
- fully regulated funds that do not qualify as CIVs only because they invest wholly or to some extent in investments other than securities; or
- alternative investment funds for “professional” or “sophisticated” investors such as real estate, private equity, private debt, venture capital, infrastructure, alternative credit and hedge funds.

These non-CIV funds may be open-ended or closed-ended (with or without a fixed life, i.e. redemption/termination rights, etc.), they may be companies, partnerships or other entities in legal form, and they may be tax transparent or not. There is no consensus on the distinction between CIVs and non-CIVs. In particular, the qualification will clearly depend on certain criteria, e.g. the notion of widely distributed or the level of investor-protection legislation required to be present in a CIV. It must be clear how the criteria are to be applied, i.e. according to the law and regulatory system, according to the statutes of the CIV or non-CIV fund or on a factual basis. For example, a fund that is owned by a small number of investors may be deemed to be widely distributed by some countries, provided that its statutes and the law allow for the distribution to a wider number of investors and actions are not taken to restrict this. In other words, it is not the actual composition of the shareholder base that counts but the principle or the law under which the fund is established. As explained in the introductory remark the GITA e.g. explicitly prohibits more than 100 investors in a specialized investment fund.
In addition, we would like to emphasize that funds investing in infrastructure, renewable energy, real estate, and other real assets as well as private equity and venture capital funds are likely to be negatively impacted by the Action 6 steps as developed at the moment so we advocate for further discussions and amendments in this regard.

**BAI in consequence advocates for:**

- maintaining and safeguarding the principle of tax neutrality between direct and indirect investing through funds
- a more intense dialogue with asset owners and alternative fund managers to address issues associated with cross-border investments in alternative asset classes
- monitoring national initiatives as the envisaged GITA to which extend they are interoperable with OECD concepts and requirements.

**B) Responses to the questions posed in the consultation documents:**

**Question 1:** What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

A threshold must take account of the nature of the investors as much as their number. If investors are themselves widely-held entities, a non-CIV fund with a sufficient level of such investors should itself be considered widely-held. Some non-CIV funds such as private equity or real estate funds may have as few as ten or twenty investors, but these will be institutional in nature.

**Question 2:** What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?
CIVs are defined as “funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection legislation in the country in which they are established.” It is not clear what level of investor-protection legislation is required to be present.

Non-CIV funds, while possessing the defining attributes of collective investment schemes, may not need to be subject to the same regulatory requirements as CIV funds. The regimes under which non-CIV funds are regulated for sale to “professional” or “sophisticated” investors may have few restrictions on the investments they may hold, the strategies and techniques they may adopt, or the concentration limits they must observe. In particular, private equity and other funds have the express object of acquiring controlling interests in companies. However, the investment principles set out in a non-CIV fund’s offering document may contain provisions relating to concentration of investments, restricting the ability to acquire a controlling interest in a company (or even a significant minority holding), prohibiting or restricting certain types of investments, and limiting the use of leverage which are identical to those to which a CIV fund is subject by law. Those investor principles generally cannot be changed without the consent of a majority of shareholders.

CIV funds and non-CIV funds and their managers are subject to a variety of regulatory regimes. For example, alternative fund managers operating in the EU are subject to regulation under the Alternative Investment Fund Managers Directive (“AIFMD”) and in the US, fund managers are subject to registration and regulation at the state level (for smaller managers) and by the Securities and Exchange Commission (SEC) for larger managers as well as by the Commodity Futures Trading Commission (CFTC). Investment funds and their managers also are subject to a wide range of securities and commodity futures laws and regulations, which govern their market conduct. Some CIV funds may fall within the scope of the same US and EU regulatory framework. On the other hand, an increasing number of alternative investment funds are UCITS products (Undertakings for the Collective Investment in Transferable Securities) that are available to retail investors as well as to sophisticated investors, in particular pension funds, and will qualify as CIV funds. These aspects of regulation identified in the question are not relevant or uniform with regard to non-CIV funds. The preferable approach would be that a non-CIV fund should be considered “regulated” for these purposes if it is formed as a collective investment scheme under the laws of a jurisdiction which requires the fund both to apply minimum standards of KYC due diligence in accordance with FATF and other regimes and to comply with FATCA and CRS reporting.

**Question 3:** Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?
In the context of a LOB, the treaty jurisdictions will have as a matter of policy a minimum participation level to be satisfied by residents of the fund jurisdiction or “equivalent beneficiaries”. It is important that the requirement on the fund to demonstrate that the level is satisfied should be administratively straightforward, such as reliance on AML and KYC due diligence and FATCA and CRS residence determinations. It may be that the Tax Relief and Compliance Enhancement (TRACE) project can be developed to enable countries to implement a system which permits intermediaries to claim treaty benefits on behalf of investors on a pooled basis, but at the same time requires the intermediaries to report beneficial owner information directly to source countries.

**Question 4:** Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

This will depend upon whether the fund is an entity treated as transparent for tax purposes by the jurisdiction in which an investor is resident or not. As explained above under the envisaged GITA typical investment funds would be treated as non-transparent for tax purposes.

**Question 5:** States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

As a LOB rule by definition seeks to limit the benefit of tax treaties to persons who are residents of the fund jurisdiction or “equivalent beneficiaries”, these treaty jurisdictions will look to provisions which set a minimum threshold of qualifying investors, such as considered above. The consequence of those provisions may be to deter investment by non-CIV funds or to necessitate non-CIV funds to limit their investors by tax residence. It is important that any requirement on the non-CIV fund should be administratively straightforward. Again, reliance on AML and KYC due diligence and FATCA and CRS residence determinations may provide a solution.

**Question 6:** One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically
payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

The aim of a non-CIV fund – as also for a CIV fund – is to ensure so far as possible tax neutrality when it invests. Any tax incurred by the non-CIV fund reduces the return to the fund and is likely to be an additional cost to investors. Therefore any intermediate structure used by a non-CIV fund will be seeking to reduce the tax liability to the lowest level imposed by the source jurisdiction. The nature of the intermediate structure and its financing will depend upon the investment being made.

**Question 7:** Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

In such a case, the transparent non-CIV fund should be regarded (whether or not it is formed under the laws of the treaty jurisdiction or is managed there) as the representative of its investors and be entitled to make claims for the benefit of the tax treaties applicable to investors. At present it is very difficult for investors to obtain effective benefit of a tax treaty in these circumstances because the fund cannot claim on behalf of investors while the investors do not have the necessary information about the relevant investments. An administratively straightforward arrangement that would permit the non-CIV fund to claim on behalf of investors is desirable.

However, consideration has to be given also to whether this proposal would affect protection where the non-CIV fund or an entity held below the non-CIV fund needs to avail itself of treaty benefits in the context of onshore investment management giving rise to a permanent establishment.

In negotiating treaties, countries could also consider whether a CIV or non-CIV fund which is not fiscally transparent nor treated as fiscally transparent under the domestic law of the country should be able to elect to be treated as fiscally transparent.

**Question 8:** The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are
often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

Institutional investors in this context are pension funds, insurance companies, occupational pension schemes, charitable endowments and other bodies formed in countries with tax treaty networks which afford benefits to them. They may be largely tax exempt (such as pension funds investing for the benefit of their pensioners) or taxable (such as insurance companies investing in respect of their own marketed investment products). The category also includes sovereign wealth funds or other government agencies which may either qualify for tax treaty benefits or enjoy sovereign immunity.

The principal purpose of non-CIV funds, like collective investment vehicles generally, is to allow investors to pool capital and gain efficient access to professional management and diverse assets. Access to treaty benefits is not per se a principal purpose of non-CIV funds, although treaty benefits may be necessary to prevent investors from suffering an additional layer of tax due to their investment through a non-CIV fund. Obtaining tax neutrality is a corollary to their investment and not a main purpose of it, and is not to be regarded as treaty shopping.

**Question 9**: Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

See introductory remark above.

**Question 10**: Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

Not answered.

**Question 11**: What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?

A bona fide investment objective is one which as its sole or primary purpose encompasses a coherent course of investment by the non-CIV fund and is not limited in its extent wholly or mainly to making investments which are identified by or agreed with investors with the purpose of obtaining treaty benefits that would not be available if the investors made the investment directly.
**Question 12:** How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

The fund’s constitution and marketing materials must state this and it must be marketed consistently with this. This would be an appropriate model.

**Question 13:** Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

This will depend upon a number of factors, not least whether the non-CIV fund is set up as “open-ended” or “closed-ended”.

In a closed-ended fund, generally no further shares or interests are issued and investors do not have the right to redeem their holdings. Unless the fund is listed and a market in its shares exists, investors will not be able readily to dispose of their holdings, and a transfer may require the consent of the fund. This structure is necessary for funds with illiquid investments, such as real estate, private equity, etc, and their investor base is accordingly largely constant.

Open-ended funds are able to issue further shares or interests and generally are required to redeem an investor’s holding at net asset value. This structure is appropriate to funds with largely liquid investments. Hedge funds are typically open-ended, though notice of redemption of a least one or three months (or longer) may be required and the fund may impose restrictions on redemption if it receives too many requests or cannot realize its investments in prevailing markets. Even so, ownership may be relatively stable as institutional investors have medium or long-term investment horizons.

**Question 14:** How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

The proposal would assist mainly those non-CIV funds with a stable institutional investor base. However, even in that case, a non-CIV fund may not be able to ascertain whether the investor is holding its interest in the non-CIV fund for its own account, or directly or indirectly for its own clients. Funds of funds are significant investors in many non-CIV funds, particularly those closed to new investors, as they provide indirect access to the underlying non-CIV fund. The non-CIV fund will not be able to determine what changes there are in the investors in the fund of funds and therefore may be unable to access treaty benefits.
**Question 15:** What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

Under these regimes, in the absence of actual knowledge of the ultimate investor, the fund and its manager or administrator will be required, in the absence of circumstances giving rise to suspicion, only to perform due diligence back to a financial institution or other authorized person subject to a compliance obligation. The information obtained relates to the identity and tax residence of the investor and the source of the capital invested, but does not extend to whether the investor is entitled to the benefit of a particular treaty or is subject to an anti-deferral tax regime in respect of its interest in the fund.

**Question 16:** Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have if they received underlying income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payers that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

This information is not currently sufficient as it does not identify whether the ultimate investor is entitled to the benefit of the treaty (e.g. whether the investor is subject to tax as well as resident in the treaty jurisdiction) or meets other conditions (such as being subject to an anti-deferral regime or having beneficial ownership of the income). More detailed information than is currently obtained would be required and would have to be frequently updated. While this might be addressed as a matter of contract in the subscription terms, this would not necessarily be effective in the case of an intermediate structure and enforcement would not be practical. Compliance with data protection laws would be required.

A failure to provide the information could prejudice the entitlement of the other investors in the non-CIV.

**Question 17:** Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple
layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

We are not clear whether this question refers to the ownership by the non-CIV fund of its investments or the ownership by an investor of its interest in the non-CIV fund. However, we do not see that this is to be distinguished from the situation where an intermediate company makes a treaty claim in its own right. The same issues as to entitlement arise. The difficulty exists in identifying the ultimate beneficial owner.

**Question 18:** The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

We assume that this proposal would apply to all non-CIV funds, whether fiscally transparent or opaque.

It is a matter for treaty jurisdictions to determine what is acceptable to them in the context of encouraging cross border investment. The measures considered in paragraph 17 (see questions 8 – 12) also address the issue.

Granting treaty benefits in proportion to the interests held by qualifying investors would ensure that no additional benefits were obtained. There should not be a requirement that the treaty benefits should accrue financially only to qualifying investors; this may be hard to achieve, both administratively and because of the legal nature of fund structures, particularly if the non-CIV fund is open-ended or is a corporate entity.

This proposal would raise other regulatory concerns, such as the prejudicial consequences for existing investors should the non-CIV fund cease to qualify for treaty benefits by reason of a change in the composition of its investor base.

**Question 19:** One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

It is a matter for treaty jurisdictions to determine what is acceptable to them in the context of encouraging cross border investment. The measures considered in paragraph 17 (see questions 8 – 12) may also address the issue.
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Comments on the Public Discussion Draft on
TREATY ENTITLEMENT OF
NON-COLLECTIVE INVESTMENT VEHICLE FUNDS

These comments have been prepared by the BEPS Monitoring Group (BMG). The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. These comments have not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. It has been drafted by Sol Picciotto and Jeffery Kadet, with contributions and comments from Andres Knobel and Tommaso Faccio.

SUMMARY

This consultation document concerns proposals put forward by interested parties and not the Committee on Fiscal Affairs, which is now asking for comments. We regret that the document did not explain the policy issues, to facilitate a wider public engagement. This is especially important since the proposals concern the BEPS Action 6 measures to prevent treaty abuse, which are a core commitment for the expanding group of countries participating in the BEPS process, and may become a global standard through tax treaties.

Non-CIVs typically include private equity funds, hedge funds, trusts or other investment vehicles that generally do not have the key characteristics of CIVs. In particular, they are usually both unregulated and narrowly held, since they are aimed at sophisticated investors. Governments are therefore right to be concerned that these non-CIVs could be used to allow access to treaty benefits, in particular reduced withholding taxes at source, for investors who would not otherwise be entitled to such benefits, and who may be able to evade being taxed on such income.

We believe that any rules created to deal with these non-CIVs should require a positive demonstration by any non-CIV desiring treaty benefits that it can verify the bona fides of all its investors. To ensure taxation of income flowing through a fund which itself is exempt from tax, measures should be in place to ensure that its investors comply with their obligations to pay tax on payments to them from the fund. Hence, we consider that, to be eligible for treaty benefits, investment funds must be subject to

- Regulation which includes know-your-customer requirements, and
- Obligations to participate in comprehensive, automatic exchange of information for tax purposes.

Where, a fund is not itself able to verify the identity of all its customers because it receives investments from other funds, it must verify that its investors are subject to the same obligations. This would provide an incentive to ensure that jurisdictions hosting financial
centres comply with the appropriate global standards, not only for financial regulation, but more importantly in this context for preventing tax evasion.

In addition, it is critical that high threshold tests be set to ensure that eligible funds are in fact widely held and are genuinely channels for portfolio investment. In particular:

- No one investor or group of related investors should own above 1% of the fund,
- The fund should have a maximum of 10% of its assets in any one investment,
- It should not own more than 5% of any such investment, and
- A minimum of 95% of funds investing in such a fund should be entitled to the same or similar treaty benefits.

**GENERAL COMMENTS**

1. Broader Policy Aspects of Rules on Investment Funds

Like our recent submission on the proposals on treatment of pension funds, we begin with some general comments on the broader implications of these proposals. Some of the comments we made in that submission are also relevant to this consultation, especially those relating to implementation through the proposed multilateral convention, and we will not repeat them here.

However, we would like to repeat that in our view it is important for there to be proper consultation and public debate on these policy issues, and we regret that these discussion drafts have focused on technical details, without even any explanation of the more general issues. The BEPS project has received strong support from political leaders due to the widespread public concerns about the evident defects of the international tax system. While repairing those defects inevitably involves some abstruse technical issues, it is essential that proposals should be formulated in a way which explains how they contribute to the broader goals identified by the G20 world leaders.

We note that the proposals under consideration here are not those of the Committee on Fiscal Affairs (CFA), but were put forward previously by interested parties, and the CFA is now requesting wider comments to facilitate its consideration of them. In our view, this strengthens the need to ensure that documents issued for consultation should clearly explain the policy considerations, to facilitate engagement by a wider range of commentators. In formulating revisions to the model tax treaty and its commentaries the CFA is creating a global standard which will have extensive effects. It is essential to ensure that consultations in this process are not limited to a narrow range of interested parties and technical specialists. Unless there is wider engagement, any resulting standards will lack both legitimacy and effectiveness.

2. Implications of Allowing Tax Treaty Benefits to Investment Funds

The Action 6 measures, of which these proposals are part, entail inclusion in tax treaties of provisions to prevent treaty shopping or other abuse of tax treaties. In particular they will allow a source state to deny exemptions from withholding taxes on payments to entities formed in the partner state principally to take advantage of the treaty. Such entities often take the form of some kind of investment vehicle. This raises the question of whether widely-held collective investment vehicles (CIVs) should be entitled to treaty benefits, which was the subject of the discussion draft on pension funds. This consultation concerns funds which are not CIVs as such, but which may have sufficient investors to be considered widely-held.
The questions raised are whether and under what conditions an investment fund can be assured of treaty benefits (i) for itself, and (ii) for its investors. The generally accepted principle is that investment income should be taxed either at the level of the fund itself, or when payments are made to beneficiaries.

Non-CIVs typically include private equity funds, hedge funds, trusts or other investment vehicles that generally do not have the key characteristics of CIVs, because they are mainly aimed at sophisticated investors. In particular, they are usually both unregulated and narrowly held. Governments are therefore right to be concerned that these non-CIVs could be used to allow access to treaty benefits, in particular reduced withholding taxes at source, for investors who would not otherwise be entitled to such benefits, and who may be able to evade being taxed on such income.

Hence, we believe that the gate must be a very high one before such vehicles could be treated as a beneficial owner qualifying for treaty benefits. Further, with their typically fewer but larger investors and narrower ownership, requirements to establish the bona fides of their investors’ qualification for treaty benefits should not normally be administratively difficult. We believe that any rules created to deal with these non-CIVs should require a positive demonstration by any non-CIV desiring treaty benefits that it can verify the bona fides of all its investors. Where, as is increasingly the case, a fund is not itself able to verify the identity of all its customers because it receives investments from other funds, it must verify that its investors are subject to the same obligations. Any exceptions will simply open a loophole for aggressive investors and tax lawyers to design around.

To ensure taxation of income which flows through a fund which is itself exempt from tax, measures should be in place to ensure that its investors comply with their obligations to pay tax on payments to them from the fund. Hence, we consider that, to be eligible for treaty benefits, investment funds must be subject to regulation which includes know-your-customer requirements and obligations to participate in comprehensive, automatic exchange of information for tax purposes. In our view this should mean compliance with the Common Reporting Standard (CRS) and the arrangements for Automatic Exchange of Tax Information developed by the OECD for the G20. This would include the USA, once it fulfills its political commitment to achieve equivalent arrangements, i.e. fully reciprocal and multilateral information exchange. This would provide an incentive to ensure that jurisdictions hosting financial centres comply with the appropriate global standards, not only for financial regulation, but more importantly in this context for preventing tax evasion.

Our responses to the specific questions reflect these general concerns.

ANSWERS TO SPECIFIC QUESTIONS

1. What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

The threshold should be that no one investor or group of related investors owns above 1% of the fund. Also, it should exclude funds which are ‘private’ or only available to a limited number of investors, whether such a limitation is achieved by a specific rule set out in the fund documentation or by the imposition of terms and conditions that would have the effect of deterring investors outside a limited group.
2. **What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal?**

We agree that the regulatory requirements described in paragraph 12 of the 2010 report on The granting of treaty benefits with respect to the income of collective investment vehicles are appropriate. From a tax perspective, it is particularly important that “[s]ales of interests in the CIV are effected through regulated entities that are subject to “know your customer” rules”, as that paragraph states. Hence, we consider that, to be eligible for treaty benefits, investment funds must be subject to regulation which includes know-your-customer requirements and obligations to participate in comprehensive, automatic exchange of information for tax purposes. In our view this should mean compliance with the Common Reporting Standard (CRS) and the arrangements for Automatic Exchange of Tax Information developed by the OECD for the G20. If a fund is not itself able to identify all its ultimate individual investors, because it receives investments from other funds, it should verify that these investors are subject to the same obligations.

In addition, given the important goal of avoiding granting treaty benefits to structured investments for which the investors would not qualify if they invested directly, the restriction of a non-CIV’s ability to use a material percentage of its funds to acquire a controlling interest in one company is not sufficient. Rather, the restriction must clearly prevent any investment that is more than a portfolio investment. Hence, we suggest the following conditions:

-- Maximum of 10% of its assets in any one investment, and
-- Maximum of 5% ownership in any one investment.

If treaty parties desire, they could of course allow their competent authorities to review and permit percentages up to, say, 10% or 15% ownership in any one investment if the evidence substantiates that it is a portfolio investment and not something more. We do not suggest that flexibility should be allowed for competent authority relief to increase the percentage level of non-CIV’s assets above 10% in any one investment.

3. **Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?**

The treaty-shopping concern requires a high bar. Considering this, the proportion of investors that are treaty-entitled should be set at 95% or higher.

Paragraph 6.31 of the 2010 CIV report appropriately comments:

Although the identity of individual investors will change daily, the proportion of investors in the CIV that are treaty-entitled is likely to change relatively slowly. Accordingly, it would be a reasonable approach to require the CIV to collect from other intermediaries, on specified dates, information enabling the CIV to determine the proportion of investors that are treaty-entitled. This information could be required at the end of a calendar or fiscal year or, if market conditions suggest that turnover in ownership is high, it could be required more frequently, although no more often than the end of each calendar quarter.
4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

There is diversity of practice regarding law and forms of organization with the manner of investor taxation often being in the hands of the principals who put together the structure in the first place. Again, this is an important reason for strong safeguards.

There should be two mandatory requirements. First is that there must be mandatory distribution for eligibility, including through intermediate entities. Second, the fund itself must be subject to reporting requirements under the Common Reporting Standard and the arrangements for AEoI. It is unacceptable to extend treaty relief to funds which do not comply with the global standards and report payments to their investors’ countries of residence.

5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

We suggest the high bars to qualification that have been included in the responses to the earlier questions.

6. One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

In most cases, the promoters and managers of non-CIV funds voluntarily create chains of intermediaries for various purposes with any tax effects being a cost of achieving the desired purpose. As such, we suggest that no special rules or status be accorded such structures. Rather, if it is felt appropriate, competent authority relief could be sought for an exception in the rare instances when an exception might be justified.

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

Transparent entities should not benefit from preferential treatment. In order to be eligible for treaty benefits, transparent entities should also be compliant with the reporting requirements under the Common Reporting Standard and the arrangements for AEoI and be able to identify the tax residence of their investors.
8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

Many institutional investors are highly sophisticated in treaty shopping. As such, we recommend against such an approach. If it is decided to institute such an approach, we suggest that a high bar such as 95% be used for qualification. Further, qualification of that 95% must be documented with the fund itself being subject to reporting requirements under the Common Reporting Standards that will result in reporting through automatic information exchange to the applicable tax authorities for all investors. It is unacceptable to extend treaty relief to funds which do not comply with the global standards and report payments to their investors’ countries of residence.

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

To avoid a fund being used as a shield for any major investors that could not otherwise qualify for treaty benefits, we suggest that this approach, if used, be restricted such that no one investor or group of related investors not documented as qualified for the same or better benefits owns above 1% of the fund.

10. Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

11. What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?

12. How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

A fund should be regarded as ‘marketed to a diverse investor base’ when the fund is not ‘private’ or only available to a limited number of investors, whether such a limitation is achieved by a specific rule set out in the fund documentation or by the imposition of terms and conditions that would have the effect of deterring investors outside a limited group.

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

Treaty benefits should only be granted to non-CIV funds which are themselves subject to regulation which includes know-your-customer requirements and obligations to participate in
comprehensive, automatic exchange of information for tax purposes, or can verify that their investors are. Where, a fund is not itself able to verify the identity of all its customers because it receives investments from other funds, it must verify that its investors are subject to the same obligations.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

This concern cannot be addressed. The 80% is far too low. A 95% or higher percentage must be used. Further, to avoid a fund being used as a shield for any major investors that could not otherwise qualify for treaty benefits, we suggest that this approach, if used, be restricted such that no one investor or group of related investors not documented as qualified for the same or better benefits owns above 1% of the fund.

19. One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

Yes, the 50% threshold proposed for the base erosion test is too generous. Payments from funds made to investors who are not entitled to treaty benefits should not exceed 5%.
20. According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

An anti-deferral regime would not be adequate if the amount taxed is lower than the actual return.

The mere existence of the U.S. PFIC regime is not at all sufficient as an acceptable regime. This is because there will only be current taxation to the extent that U.S. investors in the PFIC have made either a qualified electing fund (QEF) election (and the PFIC complies with certain QEF reporting requirements) or a mark-to-market election. If an investor does not make one of these elections, then there will be no current taxation.

With the inability of the PFIC to know about the elections made by its U.S. investors (this would be confidential tax return information not available to the PFIC unless voluntarily supplied), this PFIC status is meaningless.

21. As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

22. The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016 (see https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-206.pdf, paragraph 4 of Article 22 “Limitation on Benefits”). Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

23. Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

No. This approach should not be used. It would be an invitation to treaty-shopping and other game-playing.
Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?

Since this approach would be elective, non-CIV funds that do not currently distribute 100% of income would not elect this status and will not be put into difficulty, except perhaps in a competitive sense.

Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?

Clearly, non-CIV funds could only make this election if the nature of their investors allowed the complete application of the treaty rules that this approach contemplates. Non-CIVs for which this is a problem would not make the election.

The practical point is that only new funds and maybe a smattering of existing funds would have the available and ongoing information that would allow them to make this election. New funds especially could up front inform investors as a provision within the fund rules and relevant contracts that there will be full withholding with no treaty benefits unless there is timely and full cooperation by the investor.

Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?

What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

This gets to an important point not raised within the description in paragraphs 22 to 30. That is oversight including auditing of the GSF. Given the importance of full compliance, such oversight and regular auditing is an absolute necessity.

The tax authorities in the country of the GSF will have little interest in spending time and resources on providing oversight and auditing of the GSF. This is because the taxes collected would be sent to the countries of source. It is also doubtful that the local tax authority could be held responsible if the oversight and audit efforts were substandard.

While we hesitate to suggest this, perhaps the terms for GSF status could include the need for detailed regular procedural audits with reports addressed to all source countries. Such audits would be paid for by the GSF, but performed by auditors selected through the agreement of the source countries.

In response to the specific question of what should be the consequences if the fund did not meet its obligations, the fund management or other persons responsible should be personally liable for all taxes, interest, and penalties. Such persons would presumably have the contractual ability to seek reimbursement of some or all amounts from fund investors, but that is a private matter between them and the investors and should not concern the source countries.

We must add that the paragraph 28 discussion regarding active business was unclear. It would be helpful to understand what was intended regarding how a set number of employees could distinguish between an active business and a passive investment activity.
25. Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

26. Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

27. Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released in February 2016 (see question 22 above). If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

The U.S. officials responsible for this document, the 2016 U.S. Model Tax Convention, in their apparent goal of absolute certainty for taxpayers have created terribly detailed provisions and the need for official recognition before a regime will be labelled a “special tax regime”. We are very concerned that this has turned an excellent and practical tool to control inappropriate uses of tax treaties into a weak and ineffective provision, which will only serve to spawn new harmful tax regimes that closely match the tests of the detailed provisions, but will grossly violate its spirit and avoid the “special” label.

We urge that the BEPS project, including the proposed multilateral convention, should not follow this path of detailed rules and should instead consider and use the “principled” approach of the original May 2015 draft. This original and thoughtful approach not only allowed identification of the vast majority of statutes, regulations, or administrative practices that should be labelled as “special tax regimes”, but it also provided that such described regimes would be so labelled unless the competent authorities of the two countries agreed to the contrary. The February 2016 final document takes the exact opposite approach with no obviously harmful regime being treated as a “special tax regime” until 30 days after a date when a written public notification has been issued, and this can only occur following consultation between the two contracting states and the identification of the regime by the harmed state to the state maintaining the harmful regime through diplomatic channels. We can hardly imagine that any rules could possibly be written that are more friendly and motivating than these to the creation of new harmful tax regimes.

28. Please describe briefly any approach not already mentioned in this consultation document or in previous comments that could address concerns related to the way in which the new treaty provisions included in the Report on Action 6 may affect the treaty entitlement of non-CIV funds without creating opportunities for treaty-shopping or tax deferral.
RE: Public Discussion Draft on Treaty Entitlement of Non-CIVs

Dear Sirs,

BlackRock, Inc. (“BlackRock”) is pleased to have the opportunity to respond to the Public Discussion Draft on the Treaty Entitlement of Non-CIV Funds issued by the OECD.

As a fiduciary for our clients, BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to address, and comment on, the issues raised by this consultation and we will continue to contribute to the thinking of the OECD on any specific issues that may assist in improving the final outcome.

We would welcome any further discussion on any of the points that we have raised.

Yours faithfully,

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[1] BlackRock is one of the world’s leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.
Introduction

We welcome the opportunity to respond to this consultation, which is an important component of the further work on non-CIV funds within Action 6: 2015 Final Report (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances).

CIVs were defined in the 2010 OECD Report as being “limited to funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established”. This is not an exhaustive definition, and views might differ as to whether any specific fund is a CIV. “Non-CIV funds” are essentially all funds that are not CIVs.

Non-CIV funds provide a vital source of capital to a wide variety of essential economic activities. Their primary goals are:

- To pool capital from different investors, allowing investors to access additional markets, diversify risk, and seek increased returns;
- Provide exposure to, and capital for, diverse asset types including small and medium-sized enterprise (“SME”) funding, private equity, non-publicly issued debt, infrastructure, and real estate.

Given the breadth of asset classes as above, and the inclusion of all funds that are not CIVs, non-CIV funds are enormously diverse, in terms of:

1. Number/type of investor;
2. Fiscal transparency/opacity;
3. Structure (both of the fund vehicle itself and the fund’s internal structure);
4. Investment mandate (asset classes and jurisdictions);
5. Commercial structure, e.g. open-ended versus closed ended, and limited life versus indefinite life.

Non-CIV funds (except those operating in a purely domestic context) pool investment from investors in different countries and make investments that are increasingly cross-border in nature. In addition, funds generally establish multiple special purpose vehicles (“SPVs”) and complex structures driven by multiple commercial factors, including financing, legal liability separation, regulation, and local investment rules. Even if tax were not relevant, it is unlikely that the fund entity itself could directly receive its income/gains from the various source countries. Thus investors, fund entities, fund SPVs and source country investments will frequently be in different jurisdictions. However, tax treaties regulate the tax outcome of bilateral transactions, e.g. an investment by a resident of one country into an asset located in another country. This raises obvious issues for non-CIV funds, as to which bilateral tax treaty should in principle be relevant for any particular investment:

1. The treaty between the source country and the fund;
2. The treaty between the source country and a fund SPV; or
3. The treaty between the source country and the investor.

We are concerned that treaty benefits may often be denied to investors investing through a non-CIV fund under the currently proposed principal purposes test (“PPT”) (as well as the limitation on benefits (“LOB”) provision). The PPT may deny treaty benefits on investments in non-CIV funds in many circumstances, which is a concern because the availability of treaty benefits is often an important consideration for investment in the non-CIV fund and for where fund entities are established. Indeed, Example D in the Commentary to the PPT (relating to a CIV) raises the concern that the PPT would deny treaty benefits to a Non-CIV fund in similar circumstances, solely because it is a Non-CIV fund. Furthermore, in the absence of clear rules, different source countries are likely to apply PPTs using different criteria – funds will of course adapt to whatever new framework governments impose upon them, but this will be challenging if there is no consistent point they can coalesce around.
Why is a Solution Needed for Non-CIV Funds?

Obtaining treaty benefits is not a per se principal purpose of non-CIV funds, although access to treaty benefits is essential to avoid imposing an additional layer of tax over that which investors would face if they invested directly.

As described above, funds do not fit naturally within the tax treaty framework, and identifying a “principled” theory of application of treaties to funds is not straightforward. However, in our view, eliminating “unprincipled” treaty access without replacing it with a workable system is not an option that is in anyone’s interests. If non-CIV funds are denied consistent and predictable access to tax treaties, this will increase tax costs within such funds (thus potentially making funds less effective than direct investment), and cause significant uncertainty in terms of tax outcomes, which may lead to:

- Mispricing of assets and fund units;
- Increased costs for investors, and fragmentation of funds, in terms of both:
  - investor bases, where each fund limits investors to those with identical tax treaty entitlement, and
  - asset classes, where limiting investments to a single class enables treaty eligibility to be simplified;
- Reduction in cross-border (as compared to domestic) investment activity, since domestic funds typically need to rely less upon tax treaties or other structuring in order to deliver a defined tax outcome to their investors; and
- Reduction in potential absolute levels of investment as non-CIV funds become subject to double taxation: larger institutional investors will be able to continue to invest directly into infrastructure and SMEs via individual mandates, but pooled investment by smaller institutions, high net worth and retail clients will be substantially reduced.

The likely resulting reduction in investor activity will damage the economies of source countries and reduce investment opportunities for investors and savers. We already see investors seeking reassurance from managers that non-CIV funds will cope in the future world, where certainty seems to be in very short supply. Managers use pricing models to evaluate investment opportunities, and increasingly questions are being raised about the tax assumptions within those models that must be answered.

However, we recognise that source country governments have valid concerns that must be addressed:

- Treaty benefits should not be allowed to non-CIV funds in inappropriate circumstances:
  - The fund (and its subsidiaries) should not be able to engage in treaty-shopping;
  - Non-CIV funds should not provide an opportunity for investors to treaty-shop;
- Non-CIV funds should not enable investors to simultaneously claim source country treaty benefits while securing long term tax deferral;
- Tax authorities must have the ability to identify which funds they should challenge, and to determine what outcome is reasonable having regard to the ultimate investor base.

The solutions adopted must result in a “principled” outcome, by respecting these concerns, while allowing non-CIV funds to continue their important role.

Solutions

We believe that the Discussion Draft correctly identifies the two possible basic approaches for granting treaty benefits in the case of investment through a non-CIV fund:

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1. The first is by granting treaty benefits to the Non-CIV fund on its own behalf and based on its own characteristics.

2. The second approach is by granting treaty benefits on the basis of the benefits to which investors would have been entitled if they had invested directly. The second approach could be administered either by having investors claim treaty benefits directly ("fiscal transparency"), by granting derivative benefits to the non-CIV fund ("derivative benefits" or "proportionate benefits") or adopting a wholly new model such as the proposed Global Streamed Fund.

The preferred approach may vary by government, but the two basic approaches are not necessarily mutually exclusive; for example, a non-CIV fund could qualify for benefits on its own behalf, or if it does not so qualify, a fiscal transparency or proportionate benefits approach could be applied.

Governments will no doubt wish to steer the industry towards preferred models, and clear guidance as to what is acceptable (and not acceptable) will be essential to this process. Additional guidance in the Commentary would be very helpful in clarifying when treaty benefits are appropriately granted to non-CIV funds, using the two approaches described above and taking into account the policy considerations expressed in the Discussion Draft. The industry will adapt to any new framework that is created, but the cost to it to do so will depend upon whether the solutions are practicable and workable.

In all cases, governments will no doubt wish to ensure that any solution protects their concern over granting treaty benefits to investors who are nonetheless able to secure long term tax deferral. This is discussed in detail in the response to question 20 below. However, there is no doubt that a system that requires not only investor identification, but also identification of whether each investor is recognising current taxation of the non-CIV fund’s income/gains, is going to be extremely complex to design. Again, governments will need to clearly define the anti-deferral regimes that qualify (or the criteria for an eligible regime) and the implications of an investor failing to meet the conditions need to be clearly articulated.

To avoid prohibitively expensive burdens, we urge that these regimes/obligations be designed on a coordinated basis, so that funds are presented with a manageable and stable requirement that still enables governments’ policy goals to be attained.

**Granting Treaty Benefits at the Level of the Non-CIV Fund**

Governments may wish to consider providing treaty benefits at the level of the non-CIV fund in appropriate circumstances, because such an approach would be administratively much simpler than an approach based on the treaty entitlement of the non-CIV fund’s investors, especially when it has a large number of investors. It is highly unlikely that a widely held non-CIV fund vehicle would have been created in a specific location for the principal purpose of treaty-shopping for any particular investor. Unlike CIVs, we believe that granting treaty benefits to non-CIV funds solely by reason of features such as whether it is regulated and widely held is unlikely to satisfy source country governments that their concerns are being met.

However, we believe there is merit in exploring a “substantial connection” approach to determining whether a non-CIV fund (and/or its fund subsidiaries) should be entitled to treaty benefits. This is discussed in our response to question 23 of the Discussion Draft.

**Granting Treaty Benefits on the Basis of Investor Identity**

We believe that there is a growing acceptance within the industry that any workable solution will be underpinned by investor identification, irrespective of which treaty (fund SPV, fund or investor) is in point. We believe that if governments provide clear and reasonable rules to define the investor documentation needed to determine treaty eligibility, non-CIV funds will create systems to collect that information. This must balance the need for operability against the policy concern of source-countries to eliminate inappropriate outcomes. Clearly this will require further work, but we believe it is achievable.
Once this is recognised, a wider range of principled solutions become possible, ranging from full tax transparency, to derivative or proportionate benefits, and ultimately to a wholly new (but ultimately very pragmatic) model such as the proposed Global Streamed Fund. Some funds will be able to achieve an efficient outcome using less complex models such as derivative benefits, while others (for example those with wider investor bases, or fund of fund structures) will need to seek solutions at the more complex end of the available options. Furthermore, if the Global Streamed Fund concept is adopted, it may be necessary to allow a range of options, rather than trying to create one all-encompassing version which might need to be excessively complex in order to accommodate all eventualities. We believe that so long as each option delivers a principled tax outcome, it should be made clear by governments that each is acceptable.

Our responses to many of the Discussion Draft’s specific questions is set out in Appendix 2 below – we have not responded to all questions. We reiterate that these are difficult issues, and workable solutions will require further detailed work and cooperation between the industry and governments. We would welcome the opportunity to take part in this process.
APPENDIX 1 - Responses to Specific Questions

1. Concerns related to the LOB provision

**NON-CIV FUNDS SET UP AS TRANSPARENT ENTITIES**

B. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

**QUESTION 7 RESPONSE**

We would firstly comment that US funds are generally designed on the basis of fiscal transparency, and are extremely successful in doing so. However, the reality is that this becomes much more complex for funds that have investors from multiple jurisdictions and that invest in multiple jurisdictions. Entities are not treated uniformly across all jurisdictions as tax transparent or opaque, and there is no global version of the US entity classification rules. In addition, lender requirements and regulatory requirements often mandate the use of particular types of entities with legal personality, and these types of entities often are not treated as fiscally transparent. Accordingly, any cross-border solution involving fiscal transparency would require all jurisdictions to allow fund entities (whatever their legal form) to be treated as tax transparent.

Administratively, treaty claims made by investors are more complex than treaty claims by funds. It is precisely for this reason that funds have commonly established intermediate holding structures:

- Claims by individual investors require an allocation of payments among investors, which may not be possible until after the end of the year once allocations are made;
- If relief at source is to be claimed, investor information must be passed to the withholding agent;
- If relief is to be claimed by refund system, it is necessary to create a system that associates the payment to the fund with each underlying investor, so that credit for the withholding tax can be properly claimed, and each investor must file refund claims. This is also a drain on government resources;

Investors in different jurisdictions are likely to be subject to different rules in their residence jurisdiction regarding how the fund vehicle’s income must be accounted for and reported. It is extremely expensive for the fund to keep those different sets of books and perform the various types of reporting, unless the fund targets itself only to investors located in a single market. The US K1 reporting system, while onerous, is successful in delivering data to ultimate investors for US tax purposes, even in fund of fund situations. This becomes unworkable when multiple investor locations are involved.

If a blended rate of withholding tax is applied to a particular income item, it will be necessary to allocate the appropriate amount of “tax drag” to the appropriate investor in order to achieve the correct result. At a minimum, this would require modifying many funds’ existing agreements, and it may not be possible under some applicable regulatory regimes, but without this, no treaty-eligible investor would accept co-investment with other investors who would introduce a higher “tax drag”.

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It may be possible to address each of the above challenges with the transparency approach, though in some cases the most obvious way to address them seems unlikely to be adopted in the current environment, given the level of coordination and standardisation needed across all jurisdictions:

- Source countries could clarify what documents are necessary to establish treaty entitlement (preferably, self-certifications as under CRS, FATCA and the US QI system);
- Source countries could establish “relief at source” systems instead of refund systems to reduce the resources needed to file refund claims, and they could establish clear procedures for how withholding agents allocate payments among different investors;
- All jurisdictions would need to allow or require fund vehicles, and entities within funds, to be treated as transparent for tax purposes;
- Difficulties concerning accounting/reporting could be addressed by having a standard accounting and reporting system for fiscally transparent entities that investors could use to satisfy their different residence jurisdiction requirements;
- An end-to-end data flow from investments to ultimate investors would be needed, since otherwise fund of funds structures would no longer be effective.

We believe that this is attainable in theory, but if governments are willing to consider the level of cooperation necessary to make a “traditional” full tax transparency regime workable, we urge governments to also consider other more pragmatic (and innovative) approaches such as the GSF that for certain funds are likely to yield better outcomes for investors and tax authorities alike.

**SUGGESTION THAT THE LOB INCLUDE A DERIVATIVE BENEFIT RULE APPLICABLE TO CERTAIN NON-CIV FUNDS**

8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

**QUESTION 8 RESPONSE**

In our view, the main intent of the proposals referred to in paras 15 to 18 of the consultation was to provide a result similar to treating the fund and all vehicle within the fund as transparent, but in a manner that is administratively simpler. It was not intended to mean that the derivative benefit rule would be applicable only to funds with specifically institutional investors. It is important that the derivative benefit rule operates whatever the type of investor, so long as the investors qualify for the appropriate level of treaty relief.

Having said that, it is clear that this concept is most relevant in the context of funds that are held substantially by investors who are of the same type. In the context of non-CIV funds, such concentration generally only occurs
amongst institutional investors, who are typically (but not always) entitled to the greatest treaty benefits.

In general, the term “institutional investors” refers to pension funds, sovereign wealth funds, and insurance companies. The problem with this label is that it applies to investors with a wide spectrum of treaty eligibility. Unless source countries are willing to create a definition (and accompanying treaty eligibility) that is broader than currently existing, tying a fund’s treaty benefits to such a definition is unlikely to be useful. Nor is it possible to state with certainty that “institutional investors” who are not treaty eligible would not engage in treaty-shopping. That is why the proposed approach does not depend on whether the investors are “institutional investors”.

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

QUESTION 9 RESPONSE

As set out in the introduction to this response, non-CIV funds cover an enormous range of entities and structures. We believe that different solutions are likely to be needed for funds within this range, because they present radically different issues. Accordingly, defining a non-CIV fund may not have much practical value beyond making it clearer what is a CIV (as defined in the 2010 Report). Broadly, the term “non-CIV fund” could refer to any entity that is not a CIV, but that is an “Investment Entity” as defined in the Standard for Automatic Exchange of Financial Account Information in Tax Matters (the “CRS”). Generally, that would include all types of managed funds, such as those investing in real assets (infrastructure, real estate including social housing, schools etc.), unlisted companies (private equity funds, venture capital funds, loan origination funds) and hedge funds. It also would include some personal holding companies and trusts, but these could be carved out if governments so wished.

10. Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

QUESTION 10 RESPONSE

The need for and design of specific anti-abuse rules would depend on the specific terms of any proposal adopted by governments. These would need to identify and address the areas of concern, and opportunities for misuse, that arise for each proposal. We believe that if reasonably constructed and balanced anti-avoidance rules could be designed that enabled a proposal to be implemented without an excessive weight of detailed rules (designed to counteract all possible misuse) this would be an acceptable compromise.

11. What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?

QUESTION 11 RESPONSE

This suggestion was included as a placeholder should governments want to distinguish between, for example, typical managed funds and personal holding companies or internal holding companies of MNEs. In principle, because the treaty benefits are based on the treaty benefits that investors
would have received if they had invested directly, there may be no need to make such a distinction.

12. How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

QUESTION 12 RESPONSE

Again, this was provided as a place holder if governments found it useful in distinguishing among types of Investment Entities. In principle, it is not necessary to the application of the proposal.

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

QUESTION 13 RESPONSE

There is no one answer to this question. For some non-CIV funds, particularly those investing in infrastructure, real estate, etc. the ownership is fairly stable – such funds would typically be closed-ended and with a stable longer investment horizon. For others, ownership may change frequently. As above, it may be necessary to design a separate solution for each end of the spectrum.

14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

QUESTION 14 RESPONSE

Where an investor is investing directly into the non-CIV fund in a non-intermediated manner, then the fund should be aware of the identity of that investor. The investor may themselves be a complex organisation, but provided the entity that they use to make the investment is properly entitled to treaty relief, that should be sufficient.

This will not be the case where investment is made via an intermediary, platform, fund of funds, etc. However, in almost all such cases, some person in the chain of intermediation will know the identity of the ultimate beneficial owners; if documentation is allowed to be done at that level then undoubtedly a workable solution can be found. We believe that requiring identification and treaty eligibility data for each investor to be obtained by the non-CIV fund itself is unlikely to be practical or commercially possible. Governments have already given thought to this problem in the context of TRACE, and processes could be designed to allow trusted financial intermediaries to collect the required data, and make this available to the relevant tax authorities.

We believe that if governments provide clear and reasonable rules to define the investor documentation needed to establish ownership and treaty eligibility, intermediaries and non-CIV funds will be able to create systems to collect and provide that information.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?
QUESTION 15 RESPONSE

In general, AML, FATCA, and CRS look to the immediate interest holder, and in many cases identify the individual beneficial owners or Controlling Persons of that interest holder. That information includes name, jurisdiction(s) of residence, and generally TIN. While the information includes jurisdiction of residence, additional information or documentation may be required to establish eligibility for benefits of the treaties entered into by that jurisdiction.

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

QUESTION 16 RESPONSE

As noted above, additional information or documentation may be needed to establish eligibility for treaty benefits. In the case of intermediated ownership, the likelihood that documents will be passed to others in the chain depends on whether the ultimate investor controls the intermediate entities. If the investor controls the intermediate entities, the documentation can be communicated. If not, for example in a fund of funds structure, the identity of the ultimate investors may be seen as competitively sensitive information, at least with respect to the investee fund vehicle. This obstacle could be addressed in many ways – including by allowing the intermediate entity to certify to the investee fund as to the eligibility of the intermediate entity's investor's on a pooled basis (and have the fund of funds report directly to the withholding agent or source country, similar to the US QI system). If the investor is not willing to provide appropriate documentation, then they would be fully withheld.

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

QUESTION 17 RESPONSE

As in the response to question 15 above, documentation and reporting could be done at the level at which the ultimate investor is identified (similar to FATCA, CRS, and the US QI system), and/or interests held by entities that cannot or will not identify their owners could be treated as not held by an investor that qualifies for treaty benefits.

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?
QUESTION 18 RESPONSE

Several provisions of the LOB provide for thresholds below 100%, including the proposed derivative benefits test, as well as the test for pension funds. These provisions balance the perceived risk to policy concerns of governments with concerns about administrability. We believe a similar balancing is appropriate in this case. It is clear that a threshold of 100% would result in complete fragmentation of funds, leading to higher costs for investors and inevitably to reduced cross-border investment, whereas a low threshold will result in opportunities for treaty-shopping that will not be acceptable to governments.

An alternative approach which reduces the risk of treaty-shopping could be achieved by allowing full treaty benefits where, say, 80% of the investors qualify for that rate, 10% are treaty eligible but entitled to lesser (but not nil) benefits, and a smaller number (perhaps 10%) are unidentified or obtain no treaty benefits. This would allow a degree of flexibility and not punish the broader compliant/eligible investor base who clearly had no treaty-shopping intention.

Proportionate benefits could also be considered to address government concerns, effectively giving investors the rate they would have been entitled to if they invested directly. This would require changes to the commercial arrangements which may not be possible for existing non-CIV funds, but it could be administrable for funds going forward. It is also worth noting that this would be administratively extremely complex for fund of fund structures.

19. One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

QUESTION 19 RESPONSE

The 50% threshold was based on the other existing LOB tests. Again, this is a lever that could be adjusted up or down to address concerns. However, it is important to note that unrelated party financing may be (and frequently is) incurred by the fund, and it is essential that such payments should not be treated as a “bad” payment for purposes of any proposed base erosion test.

20. According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

QUESTION 20 RESPONSE

We would firstly point out that governments’ concerns on deferral appear to misunderstand the nature of the operation and purpose of funds, and that tax deferral will only rarely be a specific intention. Furthermore, as many commentators have pointed out, many non-CIV funds (especially closed ended, limited life funds) are incentivised to return cash when disposal are made because holding cash reduces returns for investors. Furthermore, even where this is not the case:
• the largest investors are often tax-exempt, and so deferral is not relevant to them; and
• Investors who are subject to anti-deferral regimes prefer to receive cash so that they do not recognize phantom income.

However, non-CIV funds cannot control whether investors establish intermediate holding entities (that would also be treaty eligible) in order to secure deferral, and some countries do not currently have anti-deferral regimes that would apply where the non-CIV retains undistributed earnings. Accordingly, we recognise that these situations may need to be policed by anti-deferral regimes.

Governments would need to define the anti-deferral regimes that qualify (or the criteria for an eligible regime) but as set out in the response to Question 7 above concerning tax transparent funds, it is extremely expensive for funds to provide the reporting required by anti-deferral regimes unless this is designed on a coordinated basis. We believe that some form of self-certification process would be required, whereby an investor must identify whether they are subject to current tax. Furthermore, the implications of an investor failing to meet the conditions needs to be clearly defined.

The U.S. PFIC regime is an example of an anti-deferral regime that could be considered, in particular the QEF model. From industry’s perspective, the more existing regimes that qualify, the better, so governments would need to balance the relevant policy interests. The question about how the source government would know goes to the broader question of establishing treaty eligibility. The LOB in particular requires the payee to make a number of determinations, and the U.S. generally allows reliance on self-certification by the payee.

To avoid prohibitively expensive burdens, we urge that, if these regimes/obligations are determined to be necessary, they be designed on a coordinated basis, so that funds are presented with a manageable and stable requirement that still enables governments’ policy goals to be attained.

21. As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

QUESTION 21 RESPONSE

This issue is also raised in the transparency model, and the answer is the same – effectively, whoever is claiming to be entitled to equivalent treaty benefits. In the case of an investor that is taxed on a current basis, it would be the first entity not treated as transparent, or in the case of a tax-exempt investor, the tax-exempt investor.

22. The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016 (see https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-206.pdf, paragraph 4 of Article 22 “Limitation on Benefits”). Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that
derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

**QUESTION 22 RESPONSE**

It is clear that the “seven or fewer” condition would be problematic. For some funds, the treatment of interest paid to an unrelated party that is not an equivalent beneficiary as a base eroding payment could also be problematic (though it is not clear whether that treatment is intended, or is a drafting ambiguity in the new U.S. Model). More broadly, the proposal was also intended to apply to the PPT, where a derivative benefits test is not explicitly provided.

**SUGGESTION THAT A “SUBSTANTIAL CONNECTION” APPROACH BE ADOPTED**

23. Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

**QUESTION 23 RESPONSE**

The premise of the “substantial connection” approach is that, if there is a sufficient connection to the jurisdiction of residence, the non-CIV fund should be entitled to the benefits of the treaties negotiated by its jurisdiction of residence.

We note that the Discussion Draft states that WP1 does not consider this approach to be viable in the context of the LOB, and so we do not explore this further. With respect to the PPT, however, we support the suggestion that certain non-CIV funds should be entitled to treaty benefits when there are substantial non-tax commercial reasons for the establishment of the non-CIV fund (or fund subsidiary) and its activities have a sufficiently substantial connection to the State of residence. If the purposes and the activities of a non-CIV fund establish a substantial connection with the State of residence, these purposes and activities should be evidence that one of the principal purposes of the organisation of the non-CIV fund (or fund subsidiary) is not to obtain treaty benefits.

Obtaining treaty benefits is not a per se principal purpose of non-CIV funds, although access to treaty benefits is necessary to avoid imposing an additional layer of tax over what investors would face if they invested directly. Non-CIV funds and holding companies are established for many non-tax commercial purposes, and they establish pooling vehicles and holding companies for a variety of reasons, including the need to pool investors’ capital, the need to leverage the investors’ capital in order to finance the investments, the need to segregate liability with respect to different investments, and the need to permit co-investment into assets at various different levels within the fund.

In deciding on the location of an entity, a fund manager takes into account various commercial considerations, for example:

- Political stability, and the regulatory and legal system;
- Legal flexibility and simplicity, particularly to facilitate co-investments;
- Flexibility to extract exit proceeds from sales of the portfolio;
- Access to appropriately qualified personnel, such as directors with regional investment expertise, knowledge of regional business
practices and the regulatory environment and legal framework; and
• Certainty of taxation of the holding company on disposal of its investments.

A fund manager’s personnel also may have responsibilities with respect to the fund entities and holding companies, including the following:

• Reviewing investment recommendations;
• Making investment decisions and monitoring investments’ performance;
• Undertaking treasury functions;
• Acting as board directors for entities in which the fund has invested;
• Maintaining the company’s books and records; and
• Ensuring compliance with regional regulatory requirements.

It would be very helpful for the Commentary to provide one or more examples clarifying that, if there are non-tax commercial purposes for the organization and activities of the entity, a principal purpose of the entity is not to obtain treaty benefits even if the availability of treaty benefits was a consideration in the location of the entity.

The criteria for activities in non-CIV funds could also look to the activities and factors that are critical to the business of investing, namely portfolio management, investment committee activities, or the location and authority of the board. More specifically, the criteria for whether a non-CIV fund has sufficient substance in the treaty jurisdiction could look to whether:

(i) The board members of the fund (or manager) are resident in the jurisdiction;
(ii) The board members resident in the jurisdiction have the relevant expertise and authority to direct the business of the fund;
(iii) The fund (or manager) has qualified personnel in the jurisdiction that can fulfil and administer the transactions undertaken by the fund;
(iv) Decisions of the board are taken in the jurisdiction; or
(v) The bookkeeping of the fund is performed in the jurisdiction.

The co-location of the fund, and fund subsidiaries, with the fund manager’s main operations has obvious commercial and practical advantages. In this case, it should generally be clearly demonstrable that those entities were located there not for a principal purpose of treaty-shopping. It is possible that governments may wish to impose additional rules in order to reduce the risk that individual investors might seek to invest via the non-CIV fund specifically to obtain better treaty benefits than those that would have been secured by direct investment.

As regards the policy objective relating to deferral, we do not believe this is any more of a concern in the case of a fund meeting substantial connection conditions as compared to any other form of fund.

Deferral concerns are discussed in more detail in the response to question 20.
24. Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
- What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

**QUESTION 24 RESPONSE**

While a broad description of the proposal has been included in the consultation document, it is possible that this contains insufficient information to allow respondents to fully understand the implications. Accordingly, we have attached a more detailed description in Appendix 2 to this document.

As described above, funds do not fit naturally within the existing tax treaty framework, and identifying a “principled” theory of application of treaties to funds is not straightforward. However, in our view, eliminating “unprincipled” treaty access without replacing this with a workable system is not an option that is in anyone’s interests. If non-CIV funds are denied consistent and predictable access to tax treaties, this will increase tax costs within such funds (thus potentially making funds less effective than direct investment), and cause significant uncertainty in terms of tax outcomes, which may lead to:

- Mispricing of assets and fund units;
- Fragmentation of funds, in terms of both:
  - investor bases, where each fund limits investors to those with identical tax treaty entitlement, and
  - asset classes, where limiting investments to a single class enables treaty eligibility to be simplified;
- Reduction in cross-border investment activity, since domestic funds typically need to rely less upon tax treaties or other structuring in order to deliver a defined tax outcome to their investors; and
- Direct investment rather than pooling, but limited only to larger institutional investors, thus eliminating smaller investors from participation.

The likely resulting reduction in investor activity will damage the economies of source-countries and reduce investment opportunities for investors and savers.

As set out in the introduction to this response, we believe that the trend is inevitably towards solutions that involve investor identification. Some funds will be able to use investor identification in a manner consistent with current tax principles (whether using full tax transparency, or derivative/proportionate benefits – in particular smaller funds, funds less engaged in cross border activity, and funds that are not used in fund of fund
contexts. As funds increase in complexity, it becomes ever more difficult to meet the demands of full tax transparency, to allocate “tax drag” to ultimate investors, and to satisfy investor reporting and anti-deferral regimes (even if these are coordinated).

The GSF model directly addresses many of these concerns in a way that is practical and pragmatic:

- Source-countries can precisely define their taxation objectives from inbound investment;
- The exemption from tax for the fund is conditioned by a GAAR - experience indicates that fund managers will then be extremely careful to ensure that the conditions are not breached, but since the fund delivers a principled tax outcome directly to investors, without ability to defer, abuse looks unlikely provided the term “fund” is appropriately defined;
- Double taxation (tax suffered inside a fund) is eliminated, which is increasingly considered to be important in view of the effect of withholding taxes on the free movement of capital;
- BEPS opportunities (within the fund structure) are eliminated, not just in the context of Action 6, but also as regards other BEPS Actions;
- Countries that wish to impose LOB eligibility conditions can do so;
- Deferral is eliminated;
- Tax uncertainty within funds is substantially reduced;
- Fund structuring and custody costs are reduced for investors;
- Funds can accept investment from all types and residencies of investors, something which is completely impossible currently – while retaining internal simplicity; and
- Funds of fund structures are enabled, because a distribution by one GSF to another can be made gross.

Implementation is of course not a simple matter, and would need further detailed work. It is clear that there are a large number of detailed points that would need to be addressed in order for this model to be adopted, and these would need to balance the need for operability against source country need for certainty and auditability. For example, the applicable GAAP (and modifications required to enable it to apply to funds) must be determined, the streams identified and defined, rules designed that determine the outcome if one stream is in a loss position, but others are in a gain position, etc.

We believe that it is not operationally complex to tag fund assets so that the source country and applicable stream of the resulting income and gains will be known. Once the treaty eligibility of a specific investor is identified and an applicable withholding tax rate is tagged to each income/gain item, the deduction of the appropriate tax is not operationally unduly complex. Similarly, the provision of data to the country of residence of the fund, to enable tax to be accounted to the source-countries, and the preparation of the distribution voucher, is also not unduly complex. The main operational complexity will result from the need to identify investors’ treaty eligibility at a sufficiently granular level.

The version of the GSF that is set out in paragraphs 22 to 30 of the consultation is intended to be elective, and to be available to closed-ended, limited-life funds where the requirement to distribute realised gains would not be inconsistent with the commercial intent of most such funds. The requirement to distribute gains is only feasible for funds that do not typically reinvest – where this is not the case, some form of deemed distribution or reporting mechanism would be needed in order to enable the fund to reinvest while not preventing tax from being received by source-countries.
We believe that a working group could be formed to discuss these issues and to successfully design a regime. Furthermore, we recognise that source-countries may be reluctant to cede the collection responsibility to another country, not only because of the novelty of the GSF proposal but also because of genuine collection concerns. However, we believe that a framework could be devised to address such concerns. We strongly believe that the prize available in terms of enabling non-CIV funds to deliver cross-border investment while achieving a principled tax outcome in a broad range of investor circumstances fully justifies the efforts that would be needed in order to deliver a workable regime.

In response to the specific questions raised by the consultation document:

**Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?**

Unless a deemed distribution system can be designed, under which source country tax is paid by the fund (and allocated to the relevant investor) and the investor taxed on a deemed distribution, yes this would of course create difficulties for such funds.

**Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?**

Where an investor is investing directly into the GSF in a non-intermediated manner, then the fund should be aware of the identity of that investor.

This will not be the case where investment is made via an intermediary, platform, fund of funds, etc. However, in almost all such cases, some person in the chain of intermediation will know the identity of the ultimate beneficial owners; if documentation is allowed to be done at that level then undoubtedly a workable solution can be found. We believe that requiring identification and treaty eligibility data for each investor to be obtained by the GSF itself is unlikely to be practical or commercially possible. Governments have already given thought to this problem in the context of TRACE, and processes could be designed to allow trusted financial intermediaries to collect the required data, and make this available to the relevant tax authorities.

We believe that if governments provide clear and reasonable rules to define the investor documentation needed to establish ownership and treaty eligibility, intermediaries and GSFs will be able to create systems to collect and provide that information.

Investors that cannot be (or refuse to be) identified, in accordance with the rules set out by governments, would be withheld at the full domestic rate applicable to the specific type of income.

**Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?**

As set out above, we recognise that source-countries may be reluctant to cede the collection responsibility to another country, not only because of the novelty of the GSF proposal but also because of
genuine collection concerns. However, we believe that a framework could be devised to address such concerns. Traditionally, this might have taken the form of source countries requiring the fund to register a local agent or representative, who would be responsible and liable for accounting for the tax. This would be very onerous for funds, and would not be in the spirit of a new framework such as the GSF. However, other routes might include having the approved financial intermediaries (who will operate the withholding system on behalf of the GSF) act as aggregating withholding agents, accountable to the various source countries, and or to have the system only apply to funds resident in territories that source countries designate as eligible.

**What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?**

If the GSF failed to meet the requirements, and thus had the exemption from source country withholding removed, this would trigger the recovery of the benefit of that exemption from the fund or specific fund entities where the income was earned.

This would create significant additional tax cost for investors, and if the cost arose because of deficiencies by the fund manager or its outsourced service providers, it might be expected that investors would seek to recover these costs from those parties. A potential "cliff-edge" liability of this magnitude would quickly become one of the most significant operational tax risks for the manager and the service providers, and so:

- We suggest that a number of inadvertent or minor breaches of conditions should be allowed, with more immediate removal of exemption limited only to very serious or deliberate breaches; and
- Fund managers should be required to annually document their (and their service providers’) processes and procedures, and to certify that these are adequate to produce accurate compliance. This would provide a good roadmap for the country of residence of the fund, and the source-countries, to audit the GSF’s tax compliance. Given the significant operational risk that would be incurred, most managers would wish to do this in any event as a matter of good governance, but such a formal requirement would enforce best practice. If fund managers (and their service providers) make reasonable and good faith efforts to comply with the processes and procedures thus articulated, this would evidence that errors would be accepted as inadvertent or minor breaches.

The question also arises as to how an investor who is over-withheld could recover such overpaid tax. We believe it is unreasonable to expect the investor to apply for refunds for each underlying source country, and that this would create unwelcome additional administrative burdens for the source-countries. We suggest that a mechanism be designed such that the withholding agent for the fund could make necessary adjustments to future payments to such an investor, subtracting the overpaid tax from the amount to be accounted to the country of residence of the fund, which similarly subtracts that amount from the amount to be accounted to the relevant source-countries.
Appendix 2
Proposal for a Global Streamed Fund Tax Model

April 2016
1. GSF Tax Model – Example Structure

- Regular streamed distributions of income/gains - WHT at appropriate rates (see slide 5)
- Co-investment (GSFs Only)
- Investment 1 Prop Co
- Internal loan finance (for cash repat, not tax)
- External loan finance
- Portfolio investments
2. GSF Tax Model – Fund of Funds Structure

Distribution to non-GSF – full withholding tax model applied
Distribution to GSF – no tax applied
3. Current Position for Non-CIV Funds

- In principle, it is highly tax-inefficient for investors if substantial tax is incurred within a fund structure:
  - Taxable investors will be subject to double taxation (i.e. both inside the fund, and in their territory of residence);
  - Tax exemption for non-taxable investors (e.g. pension funds) will not be achieved, and the rate of tax suffered will be increased by the co-investment by taxable investors.

- Tax transparent structures, which might alleviate the above problem, are extremely difficult to design and administer in complex asset classes where the investor base is wide:
  - US “check the box” transparency is not a global concept;
  - Production of reporting even to a single country (i.e. the US) is complex and would be impractical for widely held structures.

- Investment structures will be increasingly subject to challenge by source countries, leading to:
  - Mispricing of assets and fund units;
  - Increased costs for investors, and fragmentation of funds, in terms of both:
    - investor bases, where each fund limits investors to those with identical tax treaty entitlement, and
    - asset classes, where limiting investments to a single class enables treaty eligibility to be simplified;
  - Reduction in cross-border (as compared to domestic) investment activity, since domestic funds typically need to rely less upon tax treaties or other structuring in order to deliver a defined tax outcome to their investors; and
  - Reduction in potential absolute levels of investment as non-CIV funds become subject to double taxation: larger institutional investors will be able to continue to invest directly into infrastructure and SMEs via individual mandates, but pooled investment by smaller institutions, high net worth and retail clients will be substantially reduced.
4. GSF Tax Model – Proposed Main Features

- Participating countries adopt a uniform national law creating the GSF:
  - Flexibility of legal form, but domiciled only in those countries;
  - Available to any entity that elects to be treated as a GSF under the law of the country of its residence.

- Proposed tax framework:
  - All entities (except portfolio investments and private equity investments) owned by a GSF and resident in a participating country are exempt from all tax in the participating countries:
    - No tax on income or gains, and no withholding tax on interest, dividends and other payments within the GSF;
    - No withholding tax on dividends and interest paid by portfolio investments located in participating countries.
  - To qualify for exemption, the GSF would be required to distribute 100% of its income and realised gains to unit holders on a regular basis;
  - Withholding tax (see next slide) on all distributions is paid to the state of residence of the GSF;
  - Tax collected by the state of residence of the GSF is transferred to the participating countries where underlying income/gain was derived;
  - Protections necessary to prevent avoidance of withholding tax, i.e. by distribution stripping or distribution arbitrage transactions, but avoidance opportunity is limited by frequent distributions;
  - Direct equity investment into fund assets only permitted by other GSFs (to prevent avoidance).

- Exemption does not apply to the PE investment itself (or any other commercial enterprise conducted by a fund entity where, for example, the number of employees exceeds say 20 – this would mean that passive commercial activities resulting from investment would be exempt, but active commercial activities would not):
  - However, to ensure a level playing field between PE fund investment and other investment, source countries can (but are not required) to grant a deemed interest deduction against income of the PE investment, up to their Action 4 limitation.
5. Withholding Tax Model

- Participating countries all adopt an article in their tax treaties that:
  - Describe the conditions for eligibility for treaty relief for investors in GSF, relevant to the income derived from that specific source country:
    - For example, if the GSF invests in US equities, when that income is streamed up to the GSF and then paid out to investors, the standard terms of a US LOB can be applied
  - Set the tax rates applicable to the each stream, for each class of investor in each different participating country. Accordingly, the withholding tax ultimately applied will vary according to:
    - Type/residence of investor;
    - Category of income/gain;
    - Specific source state.
- The categories of income/gains that are streamed are agreed by participating countries – these would include:
  - Dividends, interest, short term gains, long term gains;
  - Specialist income categories, including real property income, real property development gains, real estate disposal gains, mineral rights, etc.
- Participating countries agree the withholding tax system mechanics (based upon the US QI model) including the quality and type of information required, and how this cascades down from the ultimate investors through the chain of qualified intermediaries.
- Payments of distributions to GSFs investing in the fund are paid without withholding tax – the obligation to withhold then passes up to that GSF as it on-distributes to investors
  - This enables fund-of-fund structures.
6. Benefits of GSF Tax Model

- Source countries can precisely define the tax they collect from inbound investment:
  - This is of particular benefit to developing countries, since they directly control the tax rates on income and gains derived from their territory;
  - Source countries can stipulate the conditions they wish for relief, including an LOB.
- The exemption from tax for the fund is conditioned by a GAAR - experience indicates that fund managers will be extremely careful to ensure that the conditions are not breached.
- Double taxation (tax suffered inside a fund) is largely eliminated:
  - This is increasingly considered to undermine free movement of capital;
  - Tax within a fund which is not creditable against investor taxation undermines the desired parity between direct investment versus investment through a fund.
- Opportunities for BEPS are eliminated.
- Tax uncertainty within funds is eliminated.
- Fund structuring and operating costs are reduced for investors.
- Funds can accept investment from all types and residencies of investors, while retaining internal simplicity.
Introduction

The British Property Federation (BPF) is the voice of property in the UK, representing businesses owning, managing and investing in property. This includes a broad range of businesses comprising property developers and owners, financial institutions, property funds, corporate and local private landlords and those professions that support the industry.

Background

Investment into commercial real estate is critical for any economy. Such investment provides high quality accommodation in which businesses – from retailers to manufacturers, leisure centres to hospitals – can carry out their activities and allows them the flexibility to adapt and relocate as business economic conditions change.

Given its bulky and illiquid nature, it is common for investors, even major institutional investors, to gain exposure through collective investment vehicles and joint venture arrangements. Such arrangements spread commercial risk among participants and give investors access to opportunities and expertise they would not have on their own. Investment in real estate through European non-CIVs is estimated to be in excess of EUR 187 billion.

While these points most obviously and commonly apply to equity investment in commercial real estate (CRE), they increasingly apply to debt investment too. The growth of market-based finance is helping many countries, including the UK, to reduce CRE risk concentration in the banking system, and collective investment in non-CIV funds has been central to that. Debt investment in European real estate via non-CIVs stands at EUR 4.3 billion.

These arrangements depend on entities within the investment structure being able to access treaty benefits in order that the ultimate investors are taxed as if they directly owned the underlying assets. If this ability were removed, the impact on real estate and our built environment would be considerable. Cross-border investment flows into property would suffer greatly as investing into other jurisdictions becomes more expensive. This would be a perverse outcome given that the purpose of double tax treaties is to facilitate cross-border investment and trade.

Key points

1. Cross border investment must be supported
A balance must be met between ensuring treaties are not easily abused and facilitating cross-border investment. A well functioning tax treaty regime is critical in ensuring that capital can flow efficiently to suitable investment opportunities. This is good for savers all over the world, as well as for productive investment in the real economy. While longer term solutions, such as a Global Streamed Fund regime or a self certification regime merit further consideration; these options would require a fundamental change to the operation of the funds industry, as well as

1 INREV Index (European Association for Investors in Non-Listed Real Estate Vehicles)
significant cross jurisdiction collaboration. As such, interim solutions will be needed to ensure that non-CIVs have certainty over their treaty eligibility status, and investors are not denied treaty access inappropriately.

2. **The CIV definition should include investments in all asset classes**
   The definition of a CIV restricts its application to funds which invest in a ‘diverse portfolio of securities’. The investments of the fund bear no relevance to the treaty eligibility of the investor and therefore, we recommend that these criteria should be extended to all asset classes, including real estate.

3. **We support a widely-held test for non-CIV funds**
   We advocate a widely held test to identify non-CIV funds which should be eligible to bypass the limitation of benefits clause. An investor in a widely held fund will not have the power to influence the structure or investment of a fund for their own tax advantage and therefore, the risk of treaty abuse in a widely held fund is negligible. This criterion is particularly important if the classification of a CIV fund continues to restrict application to funds which invest in securities.

4. **Equivalent beneficiary**
   We are supportive of an equivalent beneficiary condition and believe a threshold of 80% equivalent beneficiaries in a fund should enable the fund to claim treaty access on behalf of the whole fund. This should only be available to widely held funds; and there would need to be a pragmatic approach to evidencing the treaty eligibility status of the fund’s investors, ideally drawing from investor data already collected under FATCA, CRS, AML etc.

5. **Transparent entities**
   Funds should be able to elect to claim treaty relief on behalf of the individual investors in the fund, whether or not the fund itself is technically transparent. This will be useful for any fund with a small number of relatively stable investors; and also a potential alternative for funds which do not meet the widely-held condition.

6. **PPT - the importance of tax neutrality for funds**
   Obtaining tax neutrality should not be regarded as treaty shopping. Tax neutrality is a necessary feature of CIV and non-CIV investment and not a main purpose of it.

7. **Real estate funds represent negligible risk of treaty abuse or tax deferral**
   Real estate income and gains are typically taxable in the country where the real estate is located at the time that the income or gain arises; so the risk of tax evasion or deferral is negligible in a real estate fund context.

Our full response is structured as follows:

*Appendix I: Responses to consultation questions*
*Appendix II: Real estate fund examples for PPT guidance*

We would welcome the opportunity to discuss any aspect of our response in more detail. Please do not hesitate to get in touch if you require further information.

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Appendix I: Responses to consultation questions

Suggestions that treaty benefits be granted (under the LOB) to regulated and/or widely-held non-CIV funds

Question 1: What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

1. A threshold must take account of the nature of the investors as much as their number. For examples, if investors are themselves widely-held entities, a non-CIV fund with a sufficient level of such investors should itself be considered widely-held. We would recommend a version of the close company rules which is used in the UK REIT legislation. This would allow a non-CIV fund to be deemed to be widely held if it is controlled by an institutional investor that is itself, widely held.

2. As noted in our previous submissions, we consider that a “widely held” condition is the most important factor in determining whether a fund should be entitled to treaty access. Where a fund is genuinely widely held, the risk that any individual investor (or small group of them) could influence the structure or investments of the fund to facilitate their own tax advantage is significantly mitigated. Therefore, we consider that the requirement for a fund to be “widely held” provides the greatest degree of protection against treaty abuse.

3. The UK tax legislation has a concept of a “Close company”, which could be suitable for these purposes. In essence, a fund would be widely held where no group of five or fewer investors (and connected persons) holds more than a 50% economic interest in the fund. An additional condition could be that no investor (and connected persons) holds more than a 20% economic interest in the fund. The fund would need a grace period of say, 18 month, to meet this threshold and may need to be deemed to continue to satisfy it while being wound up. The fund should also meet the test if it is being actively marketed with a view to becoming widely held. Such a rule already exists, inter alia, in the UK Property Authorised Investment Funds legislation.

Question 2: What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

4. We do not consider that regulation should be a condition for treaty access. In particular, it is not clear how the regulatory requirements identified in the question would provide any protection against treaty abuse or tax deferral; and as such, we do not recommend that regulatory criteria should be introduced.

Question 3: Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

5. The non-CIV fund should be able to demonstrate that a large majority (say, 80% or more) or their investors are “equivalent beneficiaries”. It is important that the requirement on the fund to demonstrate that this threshold is satisfied should be administratively straightforward, such as reliance on AML and KYC due diligence and FATCA and CRS residence determinations. There may need to be tailored rules or grace periods where the fund is starting up or winding down.
6. In order to further reduce the risk of non-CIV structures being used by non-treaty eligible investors, the OECD could consider introducing provisions that deny treaty benefits to any fund which is more than say, 10%, owned by a single non-equivalent beneficiary and their connected parties.

7. Where either of these safeguards are breached; the fund should still be able to claim treaty benefits in proportion to the level of treaty eligible investors in their fund. This will impose a significant administrative burden on the fund; but at least ensures that treaty eligible investors are not put at a disadvantage as a result.

**Question 4:** Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

8. Real estate income and gains are typically taxable in the country where the real estate is located as they arise; so the risk of tax evasion or deferral is negligible in a real estate fund context.

9. Once real estate income and gains have been made at the level of the investment; the cash will generally be repatriated straight to investors; net of any cash needed for repairs, maintenance or improvements to the assets. A fund’s performance is typically measured on the annual return it provides to its investors so there is significant commercial pressure to repatriate profits to investors as quickly as possible. Therefore, the risk of tax deferral on the investors’ returns is negligible in the context of a real estate fund.

**Question 5:** States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

10. See response to question 3.

**Question 6:** One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

11. The aim of a non-CIV fund – as also for a CIV fund – is to ensure so far as possible tax neutrality when it invests. Any tax incurred by the non-CIV fund reduces the return to the fund and is likely to be an additional cost to investors. Therefore any intermediate structure used by a non-CIV fund will be seeking to reduce the tax liability to the lowest level imposed by the source jurisdiction. The nature of the intermediate structure and its financing will depend upon the investment being made.

**Non-CIV funds set up as transparent entities**

**Question 7:** Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems
that would prevent the application of the new transparent provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

12. Transparent entities should be able to elect to be regarded as the representatives of the investors in the fund and be able to make treaty claims on their behalf. This is particularly important where the fund is widely held and it would be unrealistic or uneconomical to perform individual treaty claims for every investor.

13. However, all funds (where technically transparent or not); should be able to elect to be treated as transparent for the purpose of claiming treaty benefits, where that is most appropriate. For example, joint venture arrangements (with 2 to 5 investors) are very common for real estate investment. Where the fund is small enough that it would be administratively simple to claim treaty benefits at the investor level; funds should have the option of doing so.

**Suggestion that the LOB include a derivative benefit rule applicable to certain non-CIV funds**

**Question 8:** The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

14. Institutional investors in this context are pension funds, insurance companies, charitable endowments and other bodies formed in countries with tax treaty networks which afford benefits to them. They may be largely tax exempt (such as pension funds investing for the benefit of their pensioners) or taxable (such as insurance companies investing in respect of their own marketed investment products). The category also includes sovereign wealth funds or other government agencies which may either qualify for tax treaty benefits or enjoy sovereign immunity. The UK REIT legislation already has a definition of institutional investor which could be drawn on for these purposes.

15. The principal purpose of non-CIV funds, like collective investment vehicles generally, is to allow investors to pool capital and gain efficient access to professional management and diverse assets. Access to treaty benefits is not per se a principal purpose of non-CIV funds, although treaty benefits may be necessary to prevent investors from suffering an additional layer of tax due to their investment through a non-CIV fund. Obtaining tax neutrality is a consequence of the investment and not a main purpose of it, and should not be regarded as treaty shopping.

**Question 9:** Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

16. A non-CIV fund would be, in the absence of further definition, any collective investment scheme which is not a CIV. CIVs are defined as “funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection legislation in the country in which they are established.” Non-CIV funds would therefore cover a spectrum from fully regulated funds that do not qualify as CIVs only because they invest wholly or to some extent in investments other than securities, to alternative investment funds for “professional” or “sophisticated” investors, which do not require the same levels of investor regulation. These non-CIV funds
may be open-ended or closed-ended (with or without a fixed life), they may be companies, partnerships or other entities in legal form, and they may or may not be tax transparent.

17. This distinction is admittedly quite arbitrary and leaves a wide variety of different funds within the “Non-CIV” bucket. As such, it may be appropriate to consider a number of different criteria or regimes which would allow different types of non-CIV fund to access treaty benefits.

Question 10: Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

18. These rules would address instances where, as a principal purpose, a non-CIV fund is used to obtain the benefit of a treaty which would not otherwise be available and would apply to non-CIV funds established and marketed expressly or implicitly with that purpose.

Question 11: What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?

19. A bona fide investment objective is one which as its sole or primary purpose encompasses a coherent course of investment by the non-CIV fund and is not limited in its extent wholly or mainly to making investments which are identified by or agreed with investors with the purpose of obtaining treaty benefits that would not be available if the investors made the investment directly.

Question 12: How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

20. The UK tax legislation relating to both regulated and unregulated funds including offshore funds uses, in a number of contexts, the concept of “genuine diversity of ownership” (GDO). This is a proxy for demonstrating that a fund is actually widely-held. It requires that a fund be intended to be, and actually is, marketed to a diverse investor base (while recognising that a narrow sector of investors may be appropriate to a particular fund). The fund’s constitution and marketing materials must state this and it must be marketed consistently with this. We would recommend a similar approach for these purposes.

Questions related to identification of the investors in a non-CIV

Question 13: Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

21. This will depend upon a number of factors, not least whether the non-CIV fund is set up as “open-ended” or “closed-ended”.

22. In a closed-ended fund, generally no further shares or interests are issued once the Fund has had its ‘final close’ and investors do not have the right to redeem their holdings. Unless the fund is listed and a market in its shares exists, investors will not be able readily to dispose of their holdings, and transfers of interests often require the consent of the fund. This structure is common for funds with illiquid investments, such as real estate, and their investor base is typically more stable than an open ended fund.

23. Open-ended funds are able to issue further shares or interests and generally are required to redeem an investor’s holding at net asset value. This structure is appropriate to funds with largely liquid investments; although can be used by some funds investing in real-estate as well. Ownership is typically more variable for an open ended fund; although could be relatively stable where the units are held by institutional investors with medium or long term investment horizons.
Question 14: How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

24. The proposal would assist mainly those non-CIV funds with a stable institutional investor base. However, even in that case, a non-CIV fund may not be able to ascertain whether the investor is holding its interest in the non-CIV fund for its own account, or directly or indirectly for its own clients. It could also be difficult to identify underlying investors where there are investments through other funds or nominees.

25. A pragmatic approach could be adopted for funds with a less stable investor base. For example, tests based on where the fund is marketed, or what the average composition of the investor base is at certain points in the year (perhaps based on dates when distributions are made).

Question 15: What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

26. Under these regimes, in the absence of actual knowledge of the ultimate investor, the fund and its manager or administrator will be required, in the absence of circumstances giving rise to suspicion, only to perform due diligence back to a financial institution or other authorised person subject to a compliance obligation. The information obtained relates to the identity and tax residence of the investor and the source of the capital invested, but does not extend to whether the investor is entitled to the benefit of a particular treaty or is subject to an anti-deferral tax regime in respect of its interest in the fund.

27. While AML regulations are not consistent across the world; the process would typically involve:

27.1. Identifying and verifying the customers identity on the basis of documents, data or information obtained from a reliable and independent source;

27.2. Identifying where applicable any beneficial owners and verifying their identities using a risk based approach; and

27.3. Obtaining information on the likely source of the funds/origins of the fund

28. Under information exchange regimes like FATCA and CRS, the following information would typically be collected:

28.1. Details of the legal identity of an investor;

28.2. Address and contact details;

28.3. Country(ies) of tax residency;

28.4. Where an entity is controlled by a beneficial owner, details of that beneficial owner; and

28.5. Details relating to the source of invested funds
Question 16: Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have if they received underlying income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

29. This information is not currently sufficient as it does not identify whether the ultimate investor is entitled to the benefit of the treaty (e.g. whether the investor is subject to tax as well as resident in the treaty jurisdiction) More detailed information than is currently obtained would be required and would have to be frequently updated. As for FATCA and CRS, in the absence of actual knowledge of the investor, the fund should be able to rely on the information provided by the investor.

30. Measures would need to be in place to ensure that failure to provide information does not prejudice the entitlement of the other investors in the non-CIV. For example, the ability for the fund to claim treaty entitlement in proportion to the number of eligible investors.

31. Pragmatic approaches could be considered in order to determine the treaty eligibility of investors. For example, in respect of individual investors in particular, it may be reasonable to assume that they are entitled to treaty access based on their residence, unless the fund has any information to the contrary.

Questions related to the prevention of treaty-shopping

Question 17: Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

32. Ideally the intermediary entities should be able to claim treaty access if the are owned by a CIV or Non-CIV which itself qualifies for treaty access. In essence, the eligibility of the top fund would allow any intermediary entities which are controlled by that fund to access treaty benefits.

Question 18: The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

33. We assume that this proposal would apply to all non-CIV funds, whether fiscally transparent or opaque.

34. It is a matter for treaty jurisdictions to determine what is acceptable to them in the context of encouraging cross border investment; although we think 80% qualifying investors seems reasonable. In reality, funds will be more concerned about breaching the 80% threshold; than trying to take advantage of the 20% margin for treaty abuse.

35. Granting treaty benefits in proportion to the interests held by qualifying investors would ensure that no additional benefits were obtained. There should not be a requirement that the treaty benefits should accrue financially only to qualifying investors; this may be hard to achieve, both administratively and because of the legal nature of fund structures, particularly if the non-CIV fund is open-ended or is a corporate entity.
36. This proposal would raise other regulatory concerns, such as the prejudicial consequences for existing investors should the non-CIV fund cease to qualify for treaty benefits by reason of a change in the composition of its investor base. In this case, it would be appropriate to allow treaty benefits on a proportional basis.

**Question 19:** One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

37. It is a matter for treaty jurisdictions to determine what is acceptable to them in the context of encouraging cross border investment.

**Questions related to the prevention of deferral**

**Question 20:** According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

38. As previously noted, the risk of tax deferral in a real estate fund context is negligible, because countries typically exercise taxing rights on real estate income and gains as they arise, in the country where the asset is located.

**Question 21:** As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?


**Questions related to the new derivative benefits provision of the United States Model**

**Question 22:** The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016 (see https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-206.pdf, paragraph 4 of Article 22 “Limitation on Benefits”). Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

40. Not answered.
Suggestion that the LOB should not deny benefits to a non-CIV resident of a State with which the non-CIV has a sufficiently substantial connection

Question 23: Are there practicable ways to design a “substance connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

41. Not answered.

Suggestion of a “global streamed fund” regime

Question 24: Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

i) Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
ii) Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
iii) Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
iv) What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

42. We believe that there will be classes of non-CIV funds for which a GSF regime would be attractive. This may be determined by a number of factors, including the legal structure of the non-CIV fund, its investor base, its strategy and its ability to meet the operational requirements of the regime. However, a GSF regime should be additional to other proposed regimes for non-CIV funds.

43. We suspect that for non-CIV funds with a diverse investor base and a higher turnover of portfolio investments, the practicalities would make it too difficult to be workable unless systems are available to match investment data to investor profiles. Therefore, the GSF regime should be an elective one, so that no non-CIV fund would be forced to use it.

44. Furthermore, such a regime would require a fundamental change to the operations of the fund industry – and would require significant multi-jurisdiction collaboration. Therefore, interim solutions for non-CIV funds will be needed while longer term solutions are explored.

Concerns related to the PPT rule

Question 25: Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

45. Many non-CIV funds are structured on the master/feeder model or use intermediate holding companies. In applying a PPT rule, regard should be had to the overall structure of the non-CIV fund and its ownership by the
ultimate investors, to ensure that all intermediary entities are deemed to be treaty eligible where the top fund is treaty eligible.

46. Appendix II provides two examples of real estate funds which we consider should be eligible for treaty access under the PPT rules; and we would recommend that these examples are included within the PPT guidance.

**Concerns with respect to conduit arrangements**

Question 26: Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

47. Not answered.

**Concerns related to the “special tax regimes” proposal**

Question 27: Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released in February 2016 (see question 22 above). If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

48. Not answered.

Question 28: Please describe briefly any approach not already mentioned in this consultation document or in previous comments that could address concerns related to the way in which the new treaty provisions included in the Report on Action 6 may affect the treaty entitlement of non-CIV funds without creating opportunities for treaty-shopping or tax deferral.

49. Although we agree with the principal objectives of combating treaty abuse, we are concerned that as drafted neither the LOB nor the PPT would give sufficient assurance to the ‘good investors’ in non-CIV funds that their rights to treaty benefit would not be adversely affected.

50. As such the concern is that the majority of good investors would be put in a position where they could be worse off investing through a non-CIV fund, than if they invest directly. Various proposals have been discussed concerning how non-CIV funds could be carved out of the current provisions. One of the key areas of concern for states is that although the majority of investors are ‘good investors’ the non-CIV fund does not necessarily have the documentary evidence necessary to identify the treaty entitlement of investors, particularly where their interest is held indirectly through intermediaries, such as fund of funds.

51. In order to balance the legitimate aim of combating treaty abuse with the need to minimise administration we would be supportive of a self certification regime for identifying investor’s tax status (similar to the US W8-BEN). The exact approach would need to be given further consideration, but could involve:

51.1. Self certification forms collected by the fund manager and made available to the fund managers’ resident tax authority for audit purposes.
51.2. These forms are available for exchange of information between the fund managers’ resident tax authority and any subsidiary or intermediary.

51.3. The fund manager advises the portfolio company about the correct amount of tax to withhold locally based upon the tax treaty status of its investors (investors could be grouped with similar investors to reduce the administrative burden).

52. This approach would give assurance to all the relevant authorities that the correct amount of tax was being withheld.
Appendix II: Real estate non-CIV fund examples for PPT guidance

As with Non-CIV funds more generally, there is a huge variety of forms of real estate funds – there is certainly no ‘one-size fits all’ description. For this reason, the guidance must not be too prescriptive and will need to include a variety of characteristics of non-CIV funds which should be eligible for treaty access.

We have illustrated below two of the more typical real estate fund structures.

**Private equity real estate fund**
A non-CIV fund, typically structured as a fiscally transparent partnership, is established to invest in a portfolio of land and property investments. The fund manager is regulated and the fund is marketed to pension schemes, sovereign wealth funds, other institutional investors and high net worth individuals, on the basis of the investment mandate of the fund. A range of investors resident in different jurisdictions commit funds to the partnership. The investment strategy of the fund is set out in the marketing materials of the Fund. It is not driven by the tax position of the investors, but on the basis that it will seek to invest in assets with the aim of increasing their value and then realising this via an exit from the investment.

Investment from the fund is made through a group holding company, RCo, established in State R. Additional holding companies (special purpose vehicles or SPVs) are set up below RCo to hold the individual assets. The primary role of these special purpose companies is generally to ensure isolation of the liabilities of and potential legal claims against each asset or relatively small group of assets. This ring fencing is typically required by external lenders as it provides them with flexibility should they need to enforce their security in order to procure repayment of the loan. This structure also provides the lender with the comfort that it will have the ability to take control of the SPV in the event of the SPV’s insolvency whilst at the same time ring fencing the real estate fund’s liabilities by ensuring that the lender’s recourse is limited to the assets secured to the lender and not to other fund assets. In deciding on the location of the holding companies, the fund manager takes into account various commercial considerations, for example:

- political stability and the regulatory and legal system;
- lender and investor familiarity;
- legal flexibility and simplicity that would facilitate co-investments;
- flexibility to extract exit proceeds from sales of the portfolio;
- access to appropriately qualified personnel; and
- certainty about taxation of the holding company on disposal of its investments.

In making the decision to locate the holding company in State R, the fund manager would consider the existence of benefits under the tax conventions between State R and the states in which the target investments are resident, but this alone would not be sufficient to trigger the application of paragraph 7. The purpose of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, if RCo’s investments are made for commercial purposes consistent with the investment mandate of the fund, it should receive treaty benefits. Unless RCo’s investments are part of an arrangement, or relate to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the tax treaties between RCo and the states in which the target investments are resident.
Real estate co-investment

RCo holds an investment in a real estate project in State S, where it co-invests with other institutional investors. These investors provide both equity and debt finance to the project through an intermediate vehicle (resident in State R) in which RCo holds a 20% interest. Under the convention between State R and State S, the withholding tax rate on dividends is reduced from 30 percent to 5%. Under the convention between State T and State S, the withholding tax rate on dividends is reduced to 10%. RCo pays tax and files tax returns in State R.

In determining which jurisdiction to locate the intermediate vehicle, the investors took into account a range of factors including political stability, investor familiarity and the certainty with regard to the tax treatment of interest and dividends, which is a commercial consideration given the scale and long term nature of these investments.

The Fund considered the existence of a benefit under the State R-State S tax convention with respect to interest and dividends, but this alone would not be sufficient to trigger the application of paragraph 7. The intention of tax treaties includes providing benefits to encourage cross-border investment. Therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. If a vehicle is established for purposes of providing finance for a real estate investment project, then after consideration of the facts and circumstances, it would not be reasonable to deny treaty benefits to the intermediate vehicle.

The conclusions of this example would apply equally if a fund invested through a series of separate entities as a regional platform. The principal purpose for the establishment of the regional platform should be considered with reference to the Fund’s economic and commercial nexus to the jurisdiction as a whole, rather than only on an ‘isolated’ entity-by-entity basis.
Marlies de Ruiter  
Head, Tax Treaties, Transfer Pricing and Financial Transactions Division  
OECD/CTPA

By email taxtreaties@oecd.org

22 April 2016

Dear Sirs

**Re: Treaty entitlement of Non-CIV Funds**

1. Introduction

I am writing to you on behalf of the British Private Equity Fund and Venture Capital Association ("the BVCA") which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 600 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers.


We have reviewed the Public Discussion Draft *Treaty Entitlement of Non-CIV Funds* dated 24 March 2016. This has clearly taken into account a broad range of responses and suggestions relating to the proposed changes and we are pleased to offer further comments in relation to each of the various proposals.

The key themes of the document are concerns about tax avoidance, specifically the concept of “treaty shopping”, and the notion that non-CIV funds could be used as vehicles to defer tax. Whilst we support the work of the OECD to combat aggressive tax avoidance, we remain unclear as to whether there are any specific examples of abuse which have given rise to these concerns.

As we have previously noted in our response to the Public Discussion draft dated 21 November 2014, private equity and venture capital funds by their very nature are unlikely to be used as vehicles for tax avoidance for the following reasons:

- Private equity and venture capital funds are formed for genuine commercial reasons, not dissimilar to traditional CIV funds;
- Such funds will be marketed to a genuinely diverse range of institutional investors;
- Such institutional investors are likely to be tax exempt or, broadly entitled to treaty benefits under different provisions;
- Fund managers are unlikely to have the relevant information to ‘treaty shop’ on behalf of a subset of investors; and
- Fund managers are generally regulated by the European Alternative Investment Fund Managers Directive or US Securities Exchange Commission and generally prohibited from discriminating between investors.
As such, we consider that the private equity fund model should present a low risk of treaty abuse.

As a general matter we would observe that most of the information requested in the discussion draft has already been provided in our responses to previous consultations. However, we have provided detailed answers to each of the questions raised in the discussion draft in the attached appendix.

We draw your attention to our recommendations as to matters to be addressed in the commentary to the PPT, an approach to formulating a derivative benefits provision to the LOB, and an alternative to the Global Streaming Fund proposal.

We would welcome an opportunity to meet with you to discuss any specific concerns and/or provide further information regarding the commercial arrangements of private equity funds. We would be pleased to work with stakeholders to refine the proposals made in our submission in order to ensure that they are practical.

3. Summary of our comments

We have provided detailed answers to each of the questions raised in the discussion draft in the attached appendix and offer the following summary of our comments:

**Private equity and the low risk of treaty abuse**

- Private equity funds are diversely held. The majority of capital committed to private equity funds is sourced from pension funds and other institutional investors which would usually be expected to qualify for treaty benefits. Private equity funds are not vehicles for treaty abuse or tax avoidance more generally; they are vehicles formed for genuine investment and risk diversification. As such there should be a low risk of treaty abuse inherent in the private equity business model.

- Private equity funds are evaluated by investors on the basis of Internal Rate of Return on cash. Furthermore, private equity fund executives are incentivised by a carried interest model, one component of which will be the need to distribute cash, often against a running “hurdle rate”. Taken together, these features make clear that private equity funds are incentivised to distribute cash as early as is practicable in the majority of circumstances. As such there should be a low risk of deferral inherent in the private equity business model.

- It is still not clear to us, therefore, why the OECD considers treaty abuse and deferral to be significant concerns, and whether these concerns arise in relation to genuine private equity or some other activity which may fall within the wider non-CIV concept. It would be helpful if specific (but anonymous) examples of concern could be given and discussed.

**The PPT**

- We support a PPT approach over an LOB approach but recognise that different states will have different preferences as to how to meet the minimum standard, and therefore...
subject to the comments below, it may be necessary to develop both approaches as to how they deal with private equity funds.

- Although we do prefer the PPT, we remain concerned that the PPT is excessively subjective and will result in fiscal authorities reaching a range of inconsistent views on similar sets of facts. The OECD have recognised that inconsistency is undesirable in itself. The PPT should be amended to be a test of the single principal purpose of a particular arrangement.

- We have proposed amendments to the commentary which seek to increase consistency and reduce subjectivity in circumstances where the PPT has been failed.

**The LOB**

- We consider that an exception for a non-CIV Fund will be the most effective in balancing the need to give assurance that there is not an unacceptable risk of treaty abuse, whilst giving funds assurance on their access to treaty benefits where certain criteria are met. We have previously put forward a “good fund” proposal which seeks to provide this balance.

- Requirements relating to the diversity of investors, regulatory frameworks, levels of substance and reporting requirements along with additional rules relating to targeted anti-avoidance rules are all potentially sensible ways of providing safeguards against treaty abuse.

- If an exception is not acceptable then we consider that derivative benefits for qualifying non-CIV funds are essential if the LOB is to be applied.

- The ultimate beneficial owner approach would represent a material change and challenge to the existing private equity fund model. Although significant quantities of information are gathered and analysed in respect of investors in order to satisfy automatic exchange of information reporting regimes such as FATCA, CDOT and imminently CRS, as well as “know your client” and similar procedures, this information does not extend to identifying the treaty characteristics of all direct and indirect investors. Therefore we do not support the UBO model as presented in the discussion draft.

- However as an alternative we consider that it would be possible to supplement existing information requirements described above in order to provide a reasonable basis by which to qualify a fund under a derivative benefits test. This would be different to TRACE, which was not designed for private equity funds and is not suitable for them.

- We consider that each investor would be required to self-certify the following information:
  
  - Its name and address;
  - any country in which it is resident for tax purposes;
any country in which it has a “permanent establishment”; and
whether it is subject to tax on income distributed by the fund.

• These features are those which many double tax treaties would use as a starting point for ascertaining whether a particular party should be afforded treaty benefits. Furthermore these features would be looked at on their own merits for this purpose, rather than considering the terms of any particular double taxation treaty, and could then form the basis of either a “threshold” or “proportionate” derivative benefit provision. We believe that this will provide sufficient comfort, when combined with a realistic understanding of the abuse risks inherent in private equity as described above, that no significant inappropriate treaty relief was being granted.

• We understand that other industry groups including the Private Equity Growth Capital Council in the US and Invest Europe, also support a self-certification approach. We would be pleased to be involved in the more detailed design of a suitable framework, if self-certification is agreed to be a suitable starting point.

The global streaming fund proposal

• We have considered the idea of a global streaming fund, recognising that it is a new idea and that agreeing such a model may be practically challenging. We believe that the model as presented could be simplified, but the principle at the core of the proposal – that the fund itself essentially takes responsibility for administering appropriate withholding based on investor characteristics – is something which could form the basis of a new fund model. However, this would require strong political consensus to overcome some of the very obvious challenges presented by such a framework, including that, in effect, and depending of course on how such a proposal was refined, recipient states could become responsible for oversight of the withholding regimes of source states, including collecting and paying over the appropriate amount of tax.

An alternative approach

• Given the concerns with all of the approaches put forward to date, as summarised above, we propose an alternative regime for non-CIV funds.

• Broadly this would operate based on a new self-certification regime: investors into funds would be required to self-certify their treaty status via new self-certification documentation similar to the US W8-BEN form, which funds currently use to ascertain treaty status where the fund may receive US source payments. These forms would be held by the fund manager and used as the basis for determining the appropriate withholding to be applied at a portfolio company level. These forms would be available for audit both in the state where the fund manager is resident and source states via information exchange provisions, which would allow fiscal authorities to gain comfort that the regime was operating correctly, and indeed challenge the operation of the scheme where necessary.
• This approach would result in source states collecting the “right” amount of tax based on the treaty characteristics of fund investors, without the need to rely on the recipient state fiscal authority. In other words, investors would be in the same withholding position as they would have been had they invested in an underlying investment directly.

• This proposal represents a significant change from our previous submissions, and it is important to note that the additional burden put upon fund managers and indeed investors would be material both in time and cost of administration. As such it would be important that the alternative regime was elective rather than mandatory. However, we consider that this additional burden would be preferable to the very real risk that the approaches contemplated thus far result in a decline in capital invested into funds, which would carry with it negative consequences for the growth of businesses requiring investment worldwide.

Thank you for taking our comments into account. If you have any additional questions regarding any of the points raised, please do not hesitate to contact me. I would reiterate our willingness to be involved in any further work in order to refine these ideas into a regime which is workable for the industry.

Yours faithfully,

[Signature]

David R Nicolson
Chairman of the BVCA Tax Committee
Appendix 1: Response to specific queries

Suggestion that certain treaty benefits be granted to regulated and/or widely held non-CIV funds

1. **What would be the threshold for determining that a fund is widely held for the purpose of such a proposal?**

   It is our view that as private equity and other non-CIV vehicles typically have a diverse investor base, hold a diverse portfolio and are subject to significant regulation, they are generally not used as vehicles for tax avoidance. We would therefore recommend that there is a Genuine Diversity of Ownership Test, similar to that which already exists for other purposes in the UK. This test would consider the proposed basis for marketing the fund and whether there is a genuine intention for the fund to be widely held. If a fund is marketed with the intention of being widely held, it is a strong indicator that the purpose of the fund is not to facilitate tax avoidance.

   As detailed in our response to question 12 below, such a test could be based on the Private Placement Memorandum (“PPM”) issued by the fund. The PPM is a formal legal document, so the test would be relatively easy to assess. The key advantage of this approach, as identified by a number of other contributors, is that it does not rely on the technical analysis of where individual investors would be treated resident.

   As identified in paragraph 8, an additional safeguard could take the form of a rule that would deny treaty benefits if, for example, 10% or more of the fund was owned by a single investor.

2. **What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirement relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in the company, prohibiting or restricting certain types of investments and limiting the use of leverage by the CV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?**

   In the European Union, private equity funds, venture capital funds, hedge funds, real estate funds and other alternative investment funds are subject to the Alternative Investment Fund Managers Directive. This imposes the same types of regulatory requirements on non-CIV funds as is required by CIV funds, with the critical difference between the approaches to regulation being the entity that is regulated. Typically with a CIV fund the fund itself will be regulated, whereas with a non-CIV fund it will be the fund manager, rather than the fund that is regulated.
Similarly, in the US, private equity funds are subject to an extensive range of regulatory supervision, including the US Securities Act, the Foreign Corrupt Practices Act, and the US Investment Advisers Act as amended by the US Dodd-Frank Wall Street Reform and Consumer Protection Act. In addition, equivalent regulatory regimes will also apply to non-CIV funds which are established and regulated in the Channel Islands.

Not all of the regulatory requirements in paragraph 16 necessarily apply to private equity funds or other non-CIV funds, for example the investment objective of a private equity fund is to take a controlling stake in a target company and therefore restrictions on the acquisition of controlling stakes and/or the use of debt would not be appropriate. However, key activities undertaken by the fund manager, including providing financial advice, the organisation and governance of the fund manager and reporting requirements are covered by these regulatory regimes. We would therefore recommend that the requirement that a qualified fund is regulated is derived from the existing regulation regimes imposed by the EU Alternative Investment Fund Managers Directive, US Securities and Exchange Commission and similar regimes where appropriate.

3. Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

As mentioned previously, private equity and other non-CIV vehicles are commercial ventures which are typically not used for tax avoidance. As such, while it is difficult or impossible to prove a negative, comfort should be taken that the risk of abuse is low.

We suggest that a definition of a “qualifying fund” could include the following features to give comfort that such funds are not being used as vehicles for tax avoidance and/or to prevent funds from engaging in treaty shopping:

- Firstly, the diversity of investors test set out in response to question 1 would require that the fund managers market the fund as genuinely diverse fund and that no more than 10% of the fund was owned by a single non-equivalent beneficiary. This requirement would prevent, say, a single dominant investor or group of investors using the fund for the purpose of treaty abuse.
- Secondly, the regulatory frameworks set out in response to question 2 would provide comfort that only genuine investment businesses meet the definition of qualified funds. In this regard we would note that the administrative burden and financial cost of obtaining appropriate regulatory approval would act as a significant disincentive to abusing the qualification.
- Thirdly, a substance condition could be imposed requiring any holding structure to be subject to a minimum standard of investment in the local economy, measured, for example, in terms of locally incurred expenditure commensurate with investment activity. This would provide comfort that holding structures are not mere shells and that real business is being carried on. Again the costs of maintaining substance in
these jurisdictions would give assurance that the fund is not engaging in treaty shopping.

- Finally, a reporting requirement could be imposed so that in order to be a qualifying fund, the fund would elect to participate in a reporting regime. This reporting regime would be designed to deliver information about investors and underlying investments. This requirement will enable authorities to scrutinise the activities of funds, and again work as a disincentive for using a non-CIV structure as a tax avoidance vehicle.

4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirement for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distributed earnings up the chain of ownership on a mandatory basis? If not how would concerns about deferral of tax be addressed?

To a large extent the capital invested into private equity funds is sourced ultimately from pension funds, sovereign wealth funds, and similar organisations which are broadly not taxable on investment returns due to the relevant domestic provisions in the jurisdictions in which they are formed. Conversely, investment by private individuals into private equity funds is modest. This question does need to be considered in this light as it is not clear to us why deferral is considered to be a concern.

The term “non CIV-funds” covers a broad range of investment activities. Whilst the tax rules will vary between jurisdictions and entities, typically we would expect to see a large amount of non-CIV funds set up as transparent entities meaning that taxable investors in a non-CIV fund are typically taxable on the investment returns received by the fund regardless of whether or not there is a distribution. Broadly, we would therefore not expect non-CIV funds to be taxed strictly on a distribution basis.

Whilst theoretically, underlying holding companies could be used to ‘block’ investment returns from flowing up to the transparent funds (and therefore the investors), in practice fund managers are keen to return funds to investors as soon as possible. The reason for this is that the prompt return of profits increases the Internal Rate of Return (“IRR”) on which the performance of the fund is based. The IRR of a fund affects, amongst other things, the ability of the fund manager to raise future funds and ultimately the amounts payable to the fund manager through carried interest and co-investment arrangements.

Finally, many funds will specifically state in the fund documentation that returns on investments are to be returned to investors as soon as possible and strictly prohibit proceeds of disposal from being re-invested other than in very narrow circumstances.

On this basis, a mandatory distribution requirement seems unnecessary, given the strong commercial incentives that fund managers have to distribute cash.
5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exemption from the LOB that would apply to any widely held fund, even if it is regulated especially since that exception would seem more generous than the exception already provided for publicly listed companies. What feature could be incorporated into a specific non-CIV exception to make it more acceptable to these states?

It is not clear why such an exception could be considered to be more generous than that afforded to publicly listed entities.

The proposed exemption for non-CIV funds from the LOB is largely for the benefit of large institutional investors which would usually be considered to be “good investors” if investing directly. Taking the proposed features identified in response to question 3, as well as being regulated and having a diverse investor base, the non-CIV fund must be able to demonstrate significant substance in the relevant state along with submitting to a reporting regime.

These last two points should give the states assurances over the exception being granted to non-CIV funds on the basis that they will be undertaking genuine commercial activity due to the substance requirement and that the relevant authorities will have a significant degree of oversight due to the reporting requirements. This should give states comfort that these vehicles are not being used as a mere tax avoidance mechanism.

6. One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any that is typically payable with respect to income received from a State of source? Are there any special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediary typically funded, debt or equity? If debt, is it unrelated party financing?

Given the diversity of investment activity undertaken by private equity funds it is difficult to say what tax might typically be paid by intermediate entities.

It is commonly the case that where a private equity fund makes an equity investment a number of holding companies are used to hold the underlying investment. There are numerous reasons for this, and the balance of these reasons will determine the structure. The factors may include debt security, facilitating the management team of the underlying business to participate in equity, ensuring that cash can be extracted efficiently, etc.

The manner of the investment into any given company will depend on the characteristics of the investment opportunity and as such this may include a mixture of debt and shares. Intermediate companies may well take on third party debt as part of this capital mix.

Non-CIV Funds Set up as Transparent Entities

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be
addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

Although this approach is supported in principle, this gives rise to two key practical difficulties. The first is that jurisdictions adopt different approaches for considering whether an entity is fiscally transparent or opaque. As private equity funds are widely held and invest in a variety of jurisdictions, this will require contracting states to recognise fund entities, whatever their legal form, to be treated as tax transparent. This is likely to cause conflict with existing local legal/fiscal practices.

The second difficulty is that this would require investors to make separate treaty claims rather than relying on a single treaty claim made by a fund. In order for investors to make this claim they would require a detailed allocation of payments amongst investors with detail of the income received, the jurisdiction this arose from and the amount of taxes withheld. This level of detailed accounting is currently not required, and a requirement to account for all withholding taxes on an investor by investor level would be a significant compliance burden.

A potential solution to mitigate the administrative burden would be to allow the fund to make the treaty claim as ‘agent’ for its investor. This approach would allow the fund to separate the investors into ‘sleeves’ of ‘good investors’ and ‘bad investors’ and ensure that claims are made on behalf of the treaty investors to ensure that they are in no worse a position.

An alternative would be for countries to provide relief at source systems, rather than refund systems. This would allow investors to obtain relief at source and reduce the compliance burden (and therefore costs) at fund level.

Suggestion that the LOB include a derivative benefit rule applicable to certain non-CIV funds

Questions related to certain aspects of the proposal

8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

There is no set definition of institutional investors, but generally it is understood to mean large institutions that invest funds on behalf of third party beneficiaries, typically meaning pension funds, sovereign wealth funds and insurance companies. It often also includes ‘fund of funds’, i.e. funds designed to invest into a broad range of non-CIV funds which are in turn marketed at smaller investors who would be unable to meet the individual capital requirements.
To put this in context, private equity funds managed in the UK raised around £10.8bn of capital in 2014. The biggest sources of fundraising were pension funds (£2.7bn); sovereign wealth funds (£1.0bn); funds of funds (£1.6bn) and insurance companies (£0.5bn). The vast majority of funding, around £9.5bn, came from overseas sources.

Broadly, whilst there is no set definition of an institutional investor, it can be seen that the types of investors identified (pension funds, sovereign wealth funds and insurance companies) would be entitled to benefits that are at least as good as the benefits that might be claimed by a non-CIV fund.

Institutional investors are seen as less likely to engage in treaty shopping as, broadly, the major institutional investors are based in developed countries (as opposed to jurisdictions considered to be tax havens) and therefore likely to have full access to treaties in most other developed jurisdictions. Therefore to the extent that any holding structure reduce source jurisdiction withholding tax by virtue of double taxation agreements, in the majority of cases it is likely that this simply has the effect of reducing administrative cost for both the source fiscal authority and the investor in obviating the need to reclaim withholding tax.

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

The concept of non-CIV funds is, to our knowledge, only relevant to the OECD’s work on treaty access for funds. It is not a concept included in AIFMD or UK tax legislation, for example.

It is relevant to note that the concept of CIV funds is largely based on the TRACE project which developed proposals which were designed to apply to CIV funds but explicitly excluded private equity from its remit. CIV funds are defined in the 2010 report as funds that are widely held, hold a diverse portfolio of securities and are subject to investor-protection regulation including “fund of funds”. A wide variety of alternative investment funds, such as private equity, venture capital, real estate and infrastructure funds all broadly share similar characteristics with a CIV fund but as they do not meet the CIV definition would fall under the non-CIV description.

This is because of the way such funds are structured and the way fund management activities are regulated. For example in private equity funds formed under English law it is typical for the fund manager to be the regulated entity, rather than the fund itself, which excludes these entities from the definition of a CIV as it currently stands.

A definition of non-CIV fund could be agreed if necessary, but we consider that leaving the term as a residual concept – i.e. it includes all funds which are not CIV funds – does not obviously raise any particular treaty concerns.

10. Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

So long as such rules targeted clear instances of abuse, such as where arrangements are contrived or artificial with the sole purpose of obtaining benefit under the treaty where it would not have otherwise been available, then this would be an acceptable addition.
The risk is that a broadly drafted ‘purpose’ or ‘intention’ test could result in a ‘hybrid’ set of rules that has all the drawbacks of the LOB and PPTs, i.e. technical complexity and uncertainty/inconsistency in application, whilst retaining none of the strengths.

11. What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?

In determining what constitutes a bona fide investment objective, the question ultimately is whether the fund in question is constituted for tax avoidance purposes or is it constituted to pursue a commercial investment objective. Another way of approaching this question would be to consider why an institutional investor would invest via a non-CIV fund instead of investing directly. Is this for a tax avoidance reason (i.e. treaty shopping) or is this in pursuit of a bona fide investment objective?

Typically private equity and venture capital business may focus on a specific area of investment, for example consumer goods or life sciences, or concentrate on a specific region (e.g. Western Europe, USA). These areas of expertise can be relatively niche, and fund managers can gain large amounts of experience working in specific markets and tracking available assets. While large institutional investors such as pension funds may have investment committees with a broad range of investment experience they may not have the detailed knowledge of all businesses in all sectors and markets, and may also lack the experienced team necessary to execute the acquisition, management, development and sale of such assets. Private equity and venture capital funds therefore offer institutional investors the opportunity to gain exposure to a specific segment of the market, where internal investment expertise in the areas might be limited. Typically institutional investors will invest across a range of funds to ensure a diversified portfolio. “Fund of funds”, broadly replicate this approach, investing in a variety of funds and offering investments to both institutional investors and private investors alike.

Typically we would therefore expect the ‘bona fide investment objective’ to include the following:

- Investing in unlisted companies in specific sectors (for example life sciences, technology start up, retail, energy, although the remit may be broader)
- Investing in unlisted companies in specific regions (Western Europe, although the remit may well be global)
- Investing in ‘special opportunities’, i.e. distressed companies
- Investing in distressed debt with a view to taking a controlling stake in a company
- Investing in small companies who have passed ‘start up’ and have entered the ‘growth’ phase of the business cycle (i.e. venture capital).

12. How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

As part of setting up a fund, a Fund Manager will produce, amongst other documents, a private placement memorandum (also often referred to as an offering document) setting out the nature of the fund, its targeted investors and the underlying risks. This document will set out the profile
of the targeted investors along with details of the likely structure and a summary of tax impacts in the regions where investments are proposed. The document will give significant information about the investment strategy and the type of investments the fund is likely to undertake.

Similarly, marketing documentation accompanying the PPM or used as part of the investment raising process (e.g. slides used in presentation) can provide additional assurance that the fund was in fact marketed at a diverse investor base.

Questions related to the identification of the investors in a non-CIV

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

Broadly, interests in non-CIV funds are fairly stable. As mentioned previously private equity and venture capital funds are generally aimed at institutional investors with the capacity to seek longer term returns. Investment returns are typically generated by investing in unlisted companies and growing the underlying business before selling the assets or listing them. As such the typical life span of a private equity or venture capital fund is between 5 and 10 years. Investments in other classes of alternative investment, such as infrastructure funds can have significantly longer life spans.

In addition, typical structures involve the use of limited partnerships, which unlike shares in an investment company or units in a unit trust are not easily transferable. Therefore there is not generally considered to be a freely traded market in partnership interests. Although there are secondary markets, these are usually aimed at facilitating exits due to, say, an inability of an investor to meet a capital call, rather than trading partnership interests as a business activity in itself.

Due to the nature of the institutional investors, the medium to long term nature of these investors and the lack of an active market for trading interests, the ownership of non CIV funds is typically quite stable, albeit there will be fluctuations in activity in line with economic and other conditions.

14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

Broadly, the issue is likely to relate to a minority, rather than a majority or indeed all of a funds investors. Where a fund is unable to determine the ultimate beneficial owner and/or treaty residence of a particular investor then the proposal would, presumably, require an assumption to be made that they are not entitled to treaty benefits. Thus, so long as the minimum percentage of investors could be identified as satisfying the requirements, the derivative benefit rule should still apply.
15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

Fund managers will be under an obligation to collect information to comply with anti-money laundering/KYC procedures as well as to comply with international exchange of information regimes such as FATCA and the Common Reporting Standard.

Typically as part of the onboarding process of new investors, the fund manager will undertake standard KYC procedures to identify their clients and to complete anti-money laundering procedures. Although the exact documents a fund will collect will vary depending on the state the fund is based in and how the manager is regulated, this process will broadly involve the following:

- Identifying and verifying the customers' identity on the basis of documents, data or information obtained from a reliable and independent source;
- Identifying where applicable any beneficial owners and verifying their identities using a risk-based approach; and
- Obtaining information on the likely source of the funds/origins of the fund.

These processes will usually be outsourced to a professional administrator. It is worth noting that reference to ‘beneficial owners’ above also requires identifying the fund manager when the investor is a fund of funds, given its ability to control the fund. In this context, reliance can generally be based on representations from the fund manager and there will not be individual identity checks on each of the funds’ investors.

The FATCA regulations require all groups to self-assess and classify each of the entities in their structures, identifying any non-US financial institutions. Where entities are identified as financial institutions, they are required to undertake due diligence on all ‘account holders’ and make reports of any and all US specified persons along with certain details including account opening and closing balances and distributions made during the year. Most jurisdictions have entered into agreements where this information is reported to the local jurisdictions’ tax authorities and this information is exchanged by the local tax authority with the IRS. Other jurisdictions have opted to report directly to the IRS.

There is no set approach to gathering the information for the due diligence process. Many funds outsource this process to the administrators which will typically send out a standard questionnaire which covers off the various FATCA classifications. Other funds may use the US W8 forms for the purpose of determining this information whilst others have adopted questionnaires devised by professional advisors or organisations such as the BVCA.

The UK and the Channel Islands and Crown Dependencies have entered into similar arrangements (“CDOT”) with the first year of reporting in 2016. The first year of reporting under the Common Reporting Standard (“CRS”) is 2017. These automatic exchange of information regimes broadly use the same framework as FATCA in terms of analysing the underlying institutions, classifying
them, performing due diligence on account holders and reporting specified account holders to the relevant tax authorities.

FATCA, CDOT and CRS, along with traditional KYC means that non-CIV funds already undertake a large amount of analysis of their investors. Whilst the exact nature of information held will vary between jurisdictions, typically we would therefore expect a fund to hold the following information in respect of each investor as a result of KYC procedures:

- Details of the legal identity of an investor;
- Address and contact details;
- Where an entity is controlled by a beneficial owner, details of that beneficial owner; and
- Details relating to the source of invested funds.

In addition we would expect a fund to hold the following information in respect of each investor as a result of compliance with automatic exchange of information regimes:

- The FATCA, CDOT and CRS classification of each investor;
- Whether any of the entities are reportable persons for each regime, or whether they are passive non-financial entities controlled by reportable persons;
- The opening and closing account balances of each investor along with amounts distributed during the year; and
- Where there are US withholding tax considerations or where W8-forms have been used to identify FATCA information, specific information about treaty residence of investors.

As such it can be seen that funds already hold a broad range of information about their investors in line with the various tax and regulatory regimes that they are subject to.

16. **Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?**

As set out in response to question 15, non-CIV funds undertake large compliance exercises in relation to the various exchange of information reporting regimes in force. This information is broadly derived from existing KYC procedures but has in recent years been supplemented by specific FATCA (and now CRS) focussed information requests. Non-CIV funds typically have a broad range of information relating to an investors’ reporting status for FATCA, CDOT or indeed CRS.

However, this is not necessarily the same information that is required to complete an analysis on whether an investor would be eligible for treaty benefits. The issue here is that the FATCA/CRS
system is based on an analysis of entities, with only financial institutions being required to report and only certain types of account holders being reportable. Where a non-CIV fund undertakes due diligence on its investors, it is only required to report on reportable individuals (e.g. US citizens for FATCA). Financial institutions (including most institutional investors such as pension funds, insurance funds and funds) effectively only need to demonstrate that they are themselves registered for FATCA, usually by providing their Global Identification Number (“GIN”). As such whilst the FATCA due diligence has resulted in detailed records for certain type of investors, it has not involved a detailed analysis of the beneficial owners of other financial institutions. Whilst this is an effective process for guarding against tax avoidance/evasion it is not designed to gather the information required to make informed decisions about treaty residence.

A solution to this issue would be to agree a form of certification for an investor’s tax treaty status which could be made available to the fiscal authority of the fund manager and thereafter to source state fiscal authorities under exchange of information provisions.

**Questions relating to the prevention of treaty-shopping**

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

Please see our response to questions 3 and 16.

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

As mentioned previously, we consider that the combination of the presence of institutional investors and strict requirements to be defined as a qualifying non-CIV fund mean that it is unlikely that private equity or venture capital funds will be used as a vehicle for treaty shopping and/or tax avoidance.

The scenario outlined above considers the possibility of a qualifying fund with as high a figure as 20% of the investors being ineligible for treaty benefit using a private equity fund as a treaty shopping vehicle. This sounds implausible for three reasons:

Firstly, the diverse nature of the investor base makes it improbable that a fund manager currently possesses sufficient information with which to ascertain the consequences of a course of action on all of the investors.

Secondly, were the fund manager able to identify a state that would provide a benefit to some small subset of investors without disadvantaging the remainder of the investors, the substance requirements to be a qualifying fund would make it expensive (and therefore uncommercial) to do so.
Finally, assuming that the combination of a reporting requirement and a targeted anti-abuse rule as discussed above are implemented, this would give local authorities the tools to identify treaty abuse and to prevent it occurring.

We would advocate a threshold of some level is included to give some flexibility where the treaty status of some beneficial owners is not able to be readily determined.

19. *One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?*

The base erosion test essentially requires that in order to qualify for treaty relief, less than 50% of an entity’s income is distributed to entities that would not be entitled to treaty relief in the originating state, subject to various exceptions for arms’ length payments for services.

This is one of a series of measures designed to prevent the risk of treaty shopping. Private equity and venture capital funds are commercial investment businesses with a relatively low risk of treaty abuse due to their diverse investor base. The combination of set criteria relating to the definition of a qualifying fund to ensure it has a diverse investor base, is regulated, has sufficient substance and is part of a reporting regime, along with rules relating to a derivative benefit requirement and the proposed 50% base erosion test ensure that there is a series of stringent tests designed to prevent base erosion.

**Questions related to the prevention of deferral**

20. *According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?*

Broadly, private equity and venture capital funds are typically established as tax transparent vehicles to ensure that the ultimate beneficial owners are taxed on their share of the underlying returns as if they had invested directly, rather than on a set distribution (i.e. dividend) from the fund vehicle. Therefore the issue of tax deferral is unlikely to be an issue that affects a large section of the proposed funds.

It is also worth considering that from a commercial perspective the performance of a fund is usually judged on the internal rate of return of the fund. This will have a significant influence in how successful a fund manager is in raising capital for future funds as well as determining the amounts payable to fund managers under co-investment or carried interest regimes. Unpaid cash
balances will adversely affect the internal rate of return so there is significant incentive for fund managers to distribute returns as and when they are made.

In terms of transparency on this matter, cash balances and details of returns will generally be included in the fund’s statutory accounts. In any event these distributions will be reportable under FATCA and the Common Reporting Standard, so contracting states will have access to this information. Similarly as part of the proposed definition of a qualifying fund, it is suggested that a reporting regime be included so that contracting states can identify investors and investments.

Anti-deferral regimes vary from country to country with the US PFIC regime and the UK offshore funds rules being examples of the different approaches that have been adopted. Broadly, the US PFIC regime would not be a suitable anti-deferral regime due to its reliance on the ‘check-the-box’ regime which is not common to most tax regimes. Without the ability to elect for opaque entities to be treated as transparent, the US PFIC regime would likely cause significant difficulty if implemented outside the US.

Given that it is likely many private equity funds and venture capital funds are likely to be transparent for tax purposes, that there is a significant incentive for fund managers to distribute cash and that, in any event, most developed countries already employ some form of anti-deferral rules, it is suggested that a separate anti-deferral regime is not required.

21. As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

Although it is possible to offer broad comments about how the investors in a fund will be taxed on allocations/distribution from a fund, without detailed consideration of their legal status, country of origin and any other arrangements that they may be party to, it would be extremely challenging for a fund manager to identify the tax arrangements of each of their investors.

The comparison here would be a publicly listed company identifying the tax status of each of its shareholders based on the records it currently keeps. Although this is possible for a large listed organisation this would be a huge exercise for smaller fund managers and likely require significant input from third party overseas tax specialists.

It is therefore suggested that, as above, given that many funds will be tax transparent and that there is a significant incentive for fund managers to distribute cash as it is received, that the issue of tax deferral is unlikely to be a significant issue.

Questions related to the new derivative benefits provision of the United States Model

22. The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016 (see https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-206.pdf, paragraph 4 of Article 22
The new derivative benefits provision would likely be significantly problematic for many non-CIV funds. This is primarily because non-CIV funds are unlikely to be formed as companies, and therefore would not be entitled to benefit under this article as it is currently worded. This provision would have to be significantly reworded to accommodate non-corporate vehicles. For example, many private equity funds are structured as limited partnerships with third party investors investing as limited partners and the fund manager acting as a general partner. The references to voting rights and share classes clearly would not work in this context.

As identified, non-CIV funds are generally widely held and therefore it is highly unlikely that 95% of the vote or value would be concentrated in the hand of 7 or fewer individuals. As a general comment, it appears that this exception is aimed at smaller closely held companies, rather than investment vehicles generally and we do not consider that it would be a reasonable template to use for designing a regime for non-CIV investment funds.

Suggestion that a “substantial connection” approach be adopted

23. Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

The concern of the working party appears to be that by managing a fund in a specific jurisdiction that a fund would be able to engage in treaty shopping by basing funds in regions that offer treaty benefits to their prospective investors. So long as such substance requirements are weighted towards looking at board level decision makers (in line with the value chain analysis approach adopted by Action Point 10) then in reality this is unlikely to be an issue for non-CIV funds.

Firstly the state of residence of the fund will have to be decided prior to on boarding any investors as the fund manager will need to be regulated in the relevant state and this will need to be disclosed in the PPM as previously described. At this stage whilst a fund manager may have a list of target investors, it is unlikely to know who will ultimately invest in their fund. Indeed, considering the costs of legal fees and regulation alone, it is unlikely that there would be sufficient incentive for a fund manager to set up the fund in a specific state with a view to using this as a selling point to a potential investor.

Secondly, whilst in theory a fund manager could set up a fund in one state, then move to another for a second fund in an attempt to treaty shop, this is unlikely to work in practice. The key personnel will need to be disclosed to potential investors on the PPM and these individuals will often meet with investors as part of the investment raising process, so these individuals are key in determining how successful this process is. Recruitment and retention are already key business issues in the private equity and venture capital industry. Considering the average length of a fund is up to 10 years, while it may be possible to relocate a fund and the majority of its staff between metropolitan hubs such as London to New York, in practice it is highly unlikely that a fund manager will be able to transfer/recruit senior executives into tax havens or other overseas jurisdictions as part of an attempt to facilitate treaty shopping.
Provided that substance requirements are based on the BEPS Action Point 10 principle of value chain analysis, in practice we do not think that treaty shopping by way of moving the business operations of the fund is a significant risk.

**Suggestion of a “Global Streamed Fund” Regime**

24. Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
- What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

We have considered the proposal and agree that it does have merit. Our initial thoughts are as follows:

- Broadly, so long as there are sensible requirements relating to the time of distributions (e.g. quarterly) and that cash can be retained to be held against specific liabilities (e.g. tax) we do not envisage that a distribution requirement should cause any significant issues. A relaxation to say 85% rather than 100% may mitigate the risk that a fund inadvertently falls out of the regime.
- This could potentially cause issues for non-CIV funds that cannot for various reasons determine the ultimate beneficiaries of their investors. The new GSF framework, alongside the new FATCA and Common Reporting Standard rules could provide a greater incentive for investors who invest to intermediaries to disclose their ultimate investment status.
- The suggestion that tax on distribution be collected by the state of residence and remitted to the state of source is likely to require a new legal framework and new processes. It is unclear how much appetite there is for this level of cooperation. However, given the momentum towards greater intergovernmental action this is something that could be addressed.
- The consequences of failing to meet the GSF conditions would need to be carefully considered, as if they were too punitive then it may make the proposition less compelling. Reducing the distribution threshold to 85% and testing the GSF criteria over time (rather than period by period) would do something to mitigate the uncertainty.
We consider these proposals to be an interesting development and something that we would be pleased to discuss in greater detail in due course.

**Additional examples for the commentary on the PPT rule**

25. Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds that are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty shopping or inappropriate granting of treaty benefits.

We offer the following example for inclusion in the commentary, and emphasise that we would be pleased to work with you in refining any proposals for the commentary in order to ensure that they represent a realistic view of the industry.

**Private Equity**

A non-CIV fund, structured as a fiscally transparent partnership, is established to invest in a portfolio of existing and unrelated trading businesses. The fund manager is regulated and the fund is marketed to a range of potential investors including pension schemes, sovereign wealth funds, other institutional investors and high net worth individuals, on the basis of a prospectus that describes the investment mandate of the fund. A range of investors resident in different jurisdictions commit funds to the partnership.

Investments in target businesses are made through one or more holding companies established in State R. In deciding on the location of the holding company, the fund manager considers a range of factors, with particular emphasis on:

- Clarity that the applicable corporate law permits timely and efficient cash extraction (for example in respect of a disposal of part of an investment). Given that the main purpose of a private equity fund is to make and realise investments, this is of paramount importance.
- Stability of the political, regulatory and legal system, bearing in mind that investments may be held for a number of years.
- Clarity that the applicable corporate law facilitates co-investment arrangements without excessive complexity.
- Mitigation of foreign exchange fluctuation exposure, or of currency control risks.
- Certainty around the taxation position of the company on disposal of the investment, again bearing in mind that investments may be held for a number of years.
- Clarity of the ownership chain, say in circumstances where fund partnerships are not clearly characterised by a source state fiscal authority.
- Availability of suitable premises, staff, and administrative support at a reasonable cost.
- Flexibility that these benefits will be available across a range of investments.
In making the decision to locate the holding companies in State R, the fund manager did consider the existence of benefits under the tax conventions between State R and the states in which the target investments are resident, but this alone would not be sufficient to trigger the application of paragraph 7. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, the companies formed in State R are established for a range of commercial purposes including those set out above, and accordingly should receive treaty benefits; it would not be reasonable to deny the benefit of the tax treaties between State R and the states in which the target investments are resident.

**Consequences of failing the PPT**

As well as including suitable examples in the commentary we are concerned that the text of the October draft does not make clear the consequences of failing the PPT. There are two main reasons for this:

- firstly, the text only affords the “possibility” of granting alternative relief. This leads to a likelihood of subjectivity and inconsistency, which is undesirable; and
- secondly, if the arrangement in question is the insertion of a holding company then the text as written presents a logical problem. This is because paragraph 16 operates by providing the person originally seeking treaty relief with the possibility of seeking alternative relief which may have been available in the absence of the arrangement which gave rise to the PPT failure. If the person and the arrangement are one and the same, then arguably no alternative relief can be available.

It is essential that should the PPT be failed then the arrangement in question is, in effect, disregarded in establishing what other treaty benefits might alternatively be afforded. This is crucial to our industry, where investors will not accept being in a worse position than they would have been had they made a particular investment directly. We recommend the following amendments to the October report:

16. Also, some States consider that...
circumstances, determines that such benefits would have been granted to that person, or to persons who own, directly or indirectly, the beneficial interests in such person, in the absence of the transaction or arrangement referred to in paragraph 7. Such person may be required to provide information about itself or the persons who own the beneficial interests in such person to such The competent authority of the Contracting State to which the request has been made will consult with the competent authority of the other State before rejecting a request made under this paragraph by a resident of that other State to support its entitlement to benefits under this paragraph 8.

17. For the purpose of this alternative provision, the determination that benefits would have been granted in the absence of the transaction or arrangement referred to in paragraph 7 and the determination of the benefits that should be granted are left to the discretion of the competent authority to which the request is made. The alternative provision grants broad discretion to the competent authority for the purposes of these determinations. The provision does require, however, that the competent authority must consider the relevant facts and circumstances before reaching a decision and must consult the competent authority of the other Contracting State before rejecting a request to grant benefits if that request was made by a resident of that other State. The first requirement seeks to ensure that the competent authority will consider each request on its own merits whilst the requirement that the competent authority of the other Contracting State be consulted if the request is made by a resident of that other State should ensure that Contracting States treat similar cases in a consistent manner and can justify their decision on the basis of the facts and circumstances of the particular case. This consultation process does not, however, require that the competent authority to which the request was presented obtain the agreement of the competent authority that is consulted.

18. The following example illustrates the application of this alternative provision. Assume that an individual who is a resident of State R and who owns shares in a company resident of State S assigns the right to receive dividends declared by that company to another company resident of State R which owns more than 10 per cent of the capital of the paying company for the principal purpose of obtaining the reduced rate of source taxation provided for in subparagraph a) of paragraph 2 of Article 10. In such a case, if it is determined that the benefit of that subparagraph should be denied pursuant to paragraph 7, the alternative provision would allow require the competent authority of State S to grant the benefit of the reduced rate provided for in subparagraph b) of paragraph 2 of Article 10 if that competent authority determined that such benefit would have been granted in the absence of the assignment to another company of the right to receive dividends.

Concerns related to the “special tax regimes” proposal
26. Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released in February 2016 (see question 22 above). If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

We do not have any comments regarding the special regimes proposal.

Other Suggestions

27. Please describe briefly any approach not already mentioned in this consultation document or in previous comments that could address concerns related to the way in which the new treaty provisions included in the Report on Action 6 may affect the treaty entitlement of non-C IV funds without creating opportunities for treaty-shopping or tax deferral.

Many of the concerns identified in the consultation document relate to the concept of treaty shopping. Our view is that due to the diverse investor base, the typical tax profile of institutional investors and the separation of ownership and manager, that private equity funds are not vehicles for tax avoidance.

Although we agree with the principal objectives of combatting treaty abuse, we are concerned that as drafted neither the LOB nor the PPT would give sufficient assurance to the ‘good investors’ in private equity funds that their rights to treaty benefit would not be adversely effected.

As such the concern is that the majority of good investors would be put in a position where they would be worse off investing through a private equity fund, than if they invest directly. Various proposals have been discussed concerning how non-CIV funds could be carved out of the current provisions. One of the key areas of concern for states is that although the majority of investors are ‘good investors’ they do not necessarily have the documentary evidence necessary to identify the treaty residence for investors that hold their interest through intermediaries, such as fund of funds.

In order to balance the legitimate aim of combatting treaty abuse with the need to minimise administration we propose the following process:

- A simple form for certifying an investor’s tax status (similar to the US W8-BEN) is agreed amongst the contracting states.
- The forms are collected by the fund manager and made available to the fund managers’ resident tax authority for audit purposes.
- These forms are available for exchange of information between the fund managers’ resident tax authority and any subsidiary or intermediary.
- The fund manager advises the portfolio company about the correct amount of tax to withhold locally based upon the tax treaty status of its investors.

This approach would give assurance to all the relevant authorities that the correct amount of tax was being withheld.
Dear Sirs,

BVI\(^1\) is grateful for the opportunity to comment on the OECD Public Discussion Draft related to concerns identified in comments received by the OECD on previous discussion drafts related to the Report on Action 6, as to how the new provisions included in the Report on Action 6 could affect the treaty entitlement of non-CIVs.

As a preliminary remark we would like to highlight that the various questions and issues raised in the discussion draft show that governments and industry are confronted with a very complex area. Due to the huge number of different views and suggestions by commentators mentioned (e.g. in text number 7 of the discussion draft) there might be the need for further detailed discussions (comparable to the discussions on the 2010 CIV report) in order to find a common understanding by governments and industry about the vehicles in question and the DTT rules that shall apply to those vehicles (e.g. a "Non-CIV-Report"). For BVI it is almost impossible to give concrete answers to single questions or to propose concrete solutions within such a short consultation period.

Nevertheless, at this stage we would like to comment as follows:

**Key question: What exactly is a "non-CIV"?**

One key to the solution of any concerns regarding the treaty entitlement of non-CIVs may lie in the clear definition of a non-CIV. On the other side, it might not be trivial to find a common understanding at OECD level. Therefore we think it was appropriate to leave it up to the contracting states (as it is for CIVs at present) to agree on what a CIV or a "non-CIV" for purposes of the specific rule in a treaty is and what not.

\(^1\) BVI represents the interests of the German investment fund and asset management industry. Its 95 members manage assets of some EUR 2.6 trillion in UCITS, AIFs and assets outside investment funds. As such, BVI is committed to promoting a level playing field for all investors. BVI members manage, directly or indirectly, the assets of 50 million private clients over 21 million households. BVI’s ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en
From our German point of view, for example, we would recommend to limit the definition of non-CIVs to closed-end investment vehicles which are not publicly distributed. Our general understanding is that investment vehicles subject to investor protection regulation, and that are sold to the public or that are open-ended and capable of having an unlimited number of investors qualify as CIVs, irrespective of the legal form and the kind of assets the CIV is invested in. Other countries might have different views, but we believe our German understanding fits to the aims of specific rules for CIVs in treaties which are enabling funds to achieve treaty access, but at the same time avoiding treaty shopping concerns.

**No clear distinction between CIVs and non-CIVs possible**

OECD defines in its 2010 CIV report CIVs for treaty purposes as "funds that are widely held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established." There are - as far as we know - no concrete definitions for "widely held", "diversified" or "security". Contracting states views might differ. Germany for example regards "Collective Investment Undertakings" as "CIVs" regardless of the concrete number of investors or the kind of assets in the fund. For example the latest DTT with Australia from end of 2015 is written in English language as follows: "The term "collective investment vehicle" means a vehicle that is widely held, holds a diversified portfolio of securities or invests directly or indirectly in immovable property for the main purpose of deriving rent, and is subject to investor-protection regulation in the State in which it is established and is...". The German wording in the treaty of "widely held" is "Publikumsfonds". This means that a German open-ended or closed ended Real Estate Investment Fund sold to the public is regarded as "CIV" according to the treaty with Australia. Thus, from our German point of view a real estate fund is not a "non-CIV", which is correct if taking into account the specifics of CIVs. The investment policy of the fund (whether it invests in securities or real estate) is irrelevant.

Other countries, however, might have a tighter understanding of the definition of CIV and the ratio behind the rules for CIV. They may, for example, conclude that real estate funds are in any case non-CIVs as they do not invest into securities and therefore do not fall under the definition of CIV as mentioned above. This may be the case due to the fact that real estate vehicles are structured for example as REITS, rather than as collective investment funds. Nevertheless, this kind of non-CIV might have the same structure and investor base, is widely held and regulated, does not raise other concerns with respect to treaty shopping issues and therefore would need comparable rules to those for CIVs (e.g. specific LoB-rules) in order to achieve treaty access. Any other outcome was not logic from our point of view.

Therefore, also non-CIVs (irrespective of how they are defined in each single case) should be able to rely on rules which are as flexible as the rules in the 2010 CIV report, taking into account the needs for different fund structures and treaty shopping concerns. Such rules should not be substantially different to those provided for CIVs.

**Structure of vehicle should be relevant for defining specific rules**

The rules in the treaties should be written in a way that it is taken into account how units in funds are distributed, how the chains of intermediaries between the fund and the end investors are structured and whether treaty shopping concerns arise. In our view it is not appropriate to implement additional clauses, tests or rules for vehicles that are even not suitable for treaty shopping.
In the course of the final report on BEPS 6 the OECD stated “...as a general rule, because the shares of publicly-traded companies and of some entities are generally widely-held, these companies and entities are unlikely to be established for treaty shopping.” In the opinion of the OECD, this logic is among other things true for entities, but unfortunately not for Collective Investment Vehicles. BVI is of the opinion that there should be no distinction for investment vehicles that are publicly traded and that they should receive the same treaty access without having to fulfill further conditions. If shares in an investment vehicles are publicly traded (e.g. in case of Exchange Traded Funds, ETFs), the vehicle is in the same position than any other company which shares are publicly traded. Therefore, for example also ETFs should receive treaty access without having to fulfill further conditions like e.g. LoB-rules.

The same logic should apply for open-ended, publicly distributed funds if the number and the identity of the investors is unknown (which is often the case for UCITS or comparable open-ended investment vehicles sold to the public). For those funds fulfilling look-through approaches or specific LoB-rules as proposed by OECD is very difficult. From our point of view, e.g. it was appropriate to provide UCITS and comparable Collective Investment Undertakings treaty access without further conditions. Those widely held and regulated vehicles represent a low risk of being used for treaty shopping purposes. First, they are open-ended vehicles, i.e. an unlimited number of investors can subscribe and redeem their fund units freely and on a daily basis. This limits the capacity of a single investor to control the vehicle for treaty shopping purposes. Second, they must fulfill risk spreading requirements, i.e. cannot be used to hold a certain position in order to benefit from a specific treaty relief on this investment. Due to the generally rather small shares the vehicle should normally not be able to influence the politics of its holdings and investors in those widely held vehicles are not able to influence any treaty shopping politics.

If the investor base is known, however, other approaches (as shown in the 2010 CIV report and the consultation paper), might be appropriate.

**Conclusion**

Due to the fact that the definition of a CIV in the 2010 CIV report is not very concrete and views of contracting states may differ, it is appropriate as shown in the 2010 CIV report that contracting states have to agree on what a CIV for purposes of the specific rule in a treaty is and what not. The same logic should apply to "non-CIVs".

We are grateful in advance for your attention to our views and welcome the opportunity to discuss these with you.

Kind regards

Peter Maier  
Holger Sedlmaier
April 22, 2016

Dear Sirs and Mesdames,

We are writing in response to the OECD’s invitation to comment on its Public Discussion Draft “Treaty Entitlement of Non-CIV Funds”, released March 24, 2016 (the “Discussion Draft”). We greatly appreciate the OECD’s interest in these matters and the opportunity to provide our comments thereon.

This letter identifies a number of challenges for pension funds and similar government-related funds (referred to in this letter as “Pension Funds”) that may result from the guidance in the report on Action 6 “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances” (the “Action 6 Report”). We recognize the tax policy objectives underlying the G20 commissioned BEPS project and the Action 6 Report and have sought to respect these objectives as part of the proposals in this letter.

The issues raised in the Discussion Draft are critically important to Pension Funds, which are an important source of global investment capital, and which invest directly and indirectly through investment entities. In 2014, pension funds (including sovereign funds) in the OECD had an estimated US$30.2 trillion of assets under management. Pension Funds contribute to the economic development of OECD countries (e.g., infrastructure) and, given their long-term investment horizon, add stability to the global economy during periods of significant financial stress.

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Many Pension Funds are increasing their international investments to diversify their portfolios and to maximize their returns. Thus, the impact of source country taxation on investment returns is of great importance to Pension Funds.²

In relation to direct investments, we welcome the recognition in the Action 6 Report that certain pension funds should be treated as treaty residents, regardless of any partial or complete tax exemption in their home jurisdiction. Many of the signatories to this letter have submitted separate comments in response to the discussion document regarding the definition of a pension fund.³

1. Introduction

Pension Funds often invest through “Non-CIVs”. For purposes of this letter, the term “Non-CIVs” refers to alternative funds (i.e., managed investment funds that are not widely held), closely held club deal and consortium arrangements, regional offices / platforms, and wholly owned investment subsidiaries. Pension Funds invest through Non-CIVs for non-tax reasons, though in many instances tax considerations may be relevant as well. The existence of tax and non-tax purposes for using a Non-CIV creates ambiguity regarding the application of the principal purposes test (the “PPT”) as applied to Non-CIVs. Appendix A provides examples of the many commercial contexts in which Non-CIVs are an integral part of a variety of investment arrangements.

This potential combination of non-tax and tax purposes creates, in our view, a significant risk that Pension Funds investing in Non-CIVs for genuine commercial reasons may be denied treaty benefits following the implementation of Action 6. If a Non-CIV is denied treaty benefits under the PPT, we are also concerned that the State of source would apply its highest domestic rate of withholding tax to income paid to the Non-CIV (even though a lower withholding tax rate could apply if the income were paid directly to the investors in the Non-CIV). Such a result would be particularly punitive to Pension Funds, which would typically be unable to recoup these taxes through a foreign tax credit mechanism because they are generally tax-exempt in their State of residence. As such, we strongly urge the OECD to issue additional guidance on the PPT to clarify its application where there are both genuine commercial and tax reasons for establishing a Non-CIV in a particular State.

In the absence of extended guidance from the OECD, the resulting uncertainty could:

² Please refer to our previous letter to the OECD, dated January 9, 2015, in connection with the OECD’s invitation to comment on its Public Discussion Draft “Follow up Work on BEPS Action 6: Preventing Treaty Abuse,” for more detailed information on the common characteristics and global trends impacting the signatories to this letter. A copy of this letter is available at page 173 to 207 through the following link: http://www.oecd.org/tax/treaties/public-comments-action-6-follow-up-prevent-treaty-abuse.pdf.
³ Please refer to our letter, done in coalition with other global funds, to the OECD, dated April 1, 2016, in connection with the OECD’s invitation to comment on its Public Discussion Draft “Treaty Residence of Pension Funds.” A copy of this letter is available at page 73 to 79 through the following link: http://www.oecd.org/tax/treaties/public-comments-received-discussion-draft-treaty-residence-pension-funds.pdf.
• Affect the availability of long-term capital to source countries;

• Create ambiguity for the pricing of investments, which could distort competition by favoring those willing to take more tax risk;

• Impact the long-term funding of public projects, including infrastructure projects (e.g., certain Pension Funds may seek a higher premium on investment to compensate for uncertainty regarding withholding tax costs); and

• Restrict the diversity of investment arrangements available to Pension Funds, which is critical to the formation of long-term diversified investment portfolios that benefit our aging populations.

Although most of the concerns raised in the Discussion Draft relate to the effect of the limitation of benefits rule (the “LOB”) on Non-CIVs, this letter primarily describes the specific concerns raised by the PPT as applied to Non-CIVs. We also provide comment on specific issues raised in the Discussion Draft, and make related suggestions regarding the treaty entitlement of Non-CIVs.

2. **Summary of our Comments**

We strongly urge the OECD to issue guidance that clarifies the application of the PPT to a Non-CIV that is not fiscally transparent and that is the beneficial owner of the relevant income. We believe that such guidance should provide that:

1. A Non-CIV should receive treaty benefits under the PPT if it exists for commercial purposes, and its activities (or that of related entities in the same State) have a sufficiently substantial connection to its State of residence, even if the availability of treaty benefits was a relevant consideration in selecting the location of the entity. This is the preferred approach due to its relative simplicity to administer, as discussed below.

2. In circumstances where the Non-CIV does not qualify for treaty benefits, investors in the Non-CIV should be entitled to treaty benefits that would have been available if they had invested directly instead of through a Non-CIV. We suggest that this can be accomplished through a proportionate benefits approach (i.e., the Non-CIV would claim the benefits, but the rate would be based on the rate(s) that would have applied if the investors had invested directly). Under this approach the PPT should be applied to the investors in the Non-CIV

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4 If the Non-CIV is treated as fiscally transparent, we understand that the provision described in paragraph 9 of the Discussion Draft (and new Article 1, paragraph 2 of the Model Tax Convention) would apply to allow investors to claim treaty benefits directly. As explained in section 3 below, however, that provision would not apply because commercial considerations often necessitate the use of entities that are not generally treated as fiscally transparent.
(which could include other Non-CIVs or holding companies) to determine whether they would qualify for treaty benefits.

If treaty benefits are not granted under either approach above, as a last resort we suggest that governments could allow, or require, investors to treat Non-CIVs as if they were fiscally transparent under the tax law of the investor’s State of residence (i.e., an extension of the approach in new Article 1, paragraph 2 of the Model Tax Convention). This approach is intended to apply regardless of the legal form of the Non-CIV and the traditional characterization of the Non-CIV as not fiscally transparent (or “opaque”) under the tax law of the investor’s State of residence. This approach is more administratively complex than the first two approaches, and would require a coordinated response by governments to ensure consistent treatment of a Non-CIV as if it were fiscally transparent by each investor’s State of residence.

3. Investor Impact of the Denial of Treaty Benefits to Non-CIVs under the PPT

We generally support the proposed new provision of the Model Tax Convention dealing with transparent entities, as included in Part 2 of the Report on Action 2 “Neutralising the Effects of Hybrid Mismatch Arrangements” (the “Action 2 Report”) and echoed in the Action 6 Report. This provision provides that income earned through a fiscally transparent entity should be considered to be “income of a resident of a Contracting State, but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.” If this provision is adopted widely and sufficient guidance is provided, it can ensure that an investor obtains treaty benefits on income earned through a Non-CIV under the treaty between the State of source and the investor’s State of residence, as long as the Non-CIV is treated as fiscally transparent by the investor’s State of residence.

However, Pension Funds often invest in Non-CIVs that are not generally treated as fiscally transparent for a number of commercial reasons. For example, third-party lenders and borrowers often require the Non-CIV to be a separate corporate entity with limited liability to limit investor liability or ring-fence collateral. Typically, these Non-CIVs are treated as opaque under the tax laws of many jurisdictions. In these circumstances, treaty entitlement is tested at the level of the Non-CIV, including the potential application of the PPT. Under the currently proposed PPT, it appears that treaty benefits may be denied to an opaque Non-CIV, because the availability of treaty benefits is often an important consideration in determining the State in which a Non-CIV is established. In the case of a Pension Fund investing through an opaque Non-CIV, such a denial of treaty benefits would be manifestly inequitable, as illustrated through the following example.

3.1 Example of Concerns with Application of PPT

A Pension Fund, resident in State T, establishes a company in State R (“RCo”) to serve as a regional investment platform. RCo invests in companies in States S (“SCo”) and U (“UCo”). For commercial reasons, RCo is a corporate entity that is treated as opaque under the tax laws of States T, R, S and U.
Dividends received by RCo from SCo and UCo are exempt from withholding tax under the treaties between State R and States S and U, respectively. If the Pension Fund received the dividends directly, the dividends received from UCo would be exempt from withholding tax under the treaty between State T and State U, but the dividends received from SCo would be liable to withholding tax at a rate of 5%.

Assuming that the availability of treaty benefits was a relevant consideration in establishing RCo in State R, it appears that the PPT could apply to deny treaty benefits on the dividends paid by SCo to RCo. This could potentially result in State S applying its highest domestic withholding tax rate, which could be as high as 30% in some States. Similar issues arise in the context of investments made through managed funds or consortia.

This example raises the related question of whether treaty benefits could be granted to a Non-CIV investment entity or its investors based on the benefits that the investors would have been entitled to if they had invested directly. In the above example, if RCo were treated as fiscally transparent in State T, a dividend paid by SCo to RCo would be liable to 5% withholding tax (rather than the domestic rate of 30%). However, Pension Funds often invest in Non-CIVs that are opaque, and most jurisdictions do not provide an elective process for determining whether an entity is opaque or transparent. Accordingly, the only recourse if treaty benefits were denied to the Non-CIV would be to rely on the optional provision described in paragraph 16 of the Commentary to the PPT, as described below.

3.2 Paragraph 16 of the Commentary to the PPT and Associated Issues

The optional provision in paragraph 16 of the Commentary to the PPT allows a Competent Authority to grant “different benefits” to a person who is denied treaty benefits under the PPT. To authorize different benefits, the Competent Authority must determine that such benefits would have been granted to “that person” in the absence of the arrangement that failed the PPT. From a policy perspective, the results of this optional provision are consistent with the alternatives that are suggested in this letter. However, we strongly believe that this provision in its current form is insufficient to provide relief to investors in Non-CIVs for four reasons:

1. It is an optional provision, and it is unclear whether many jurisdictions will adopt it in their treaties.

2. In the case of a Non-CIV that fails the PPT, the OECD guidance recommends that the Competent Authority ignore the existence of the Non-CIV. However, it is not clear what “different benefits” would be granted if the Non-CIV were ignored. If the intended result is to provide benefits based on the benefits that would have been granted to the investors if the investors had invested directly (whether by another treaty, EU law or relieving domestic law provisions applicable to Pension Funds), an example in the Commentary clarifying this result would be helpful.
3. In our experience, Competent Authorities are reluctant to grant discretionary relief in the absence of clear guidance as to objective criteria forming a basis for the relief sought. It would be helpful if the provision included a non-exhaustive list of factors which, if present, would entitle the applicant to “different benefits”.

4. The Competent Authority process is often a cumbersome and time-consuming for both taxpayers and governments. Requiring all Non-CIVs to rely on that process is not practical given the volume of transactions involved. For example, to provide a sense of the potential volume, one of the Pension Funds in this group closed over 115 direct and fund investments in 2015 alone, of which 40 deals were in excess of $200 million. Requiring Pension Funds to access Competent Authorities for certainty in respect of this volume of transactions will further stress an already overburdened system. Moreover, discretionary benefits are generally not given *ex ante*, and therefore do not provide the certainty needed to make cross-border investments. Thus, Pension Funds may refrain from making certain investments if there exists significant regulatory uncertainty in a target State. In our view, a discretionary relief provision should only be used in exceptional circumstances as it would otherwise impose a heavy burden on both tax administrations and investors.

Due to the foregoing issues with paragraph 16 of the Commentary to the PPT, we do not believe that it provides a sufficient solution. Therefore, we suggest that, in addition to the adoption of this discretionary relief, governments should adopt the following proposed approaches.

### 3.3 Proposed Approaches to Address Uncertainty

To address the uncertainty regarding the application of the PPT to opaque Non-CIVs, we suggest that there are two basic approaches for granting treaty benefits where an investment is made through a Non-CIV:

1. Granting treaty benefits to the Non-CIV on its own behalf (the “*direct benefits approach*”)

2. Granting treaty benefits based on the benefits that each individual investor would have been entitled to if it had invested directly. This approach could be administered by granting direct proportionate benefits to the Non-CIV (the “*proportionate benefits approach*”).

The preferred approach may vary by government, but the two basic approaches are not mutually exclusive. For example, a Non-CIV could qualify for benefits on its own behalf; or if it does not so qualify, a proportionate benefits approach could be applied.

Additional guidance in the Commentary is needed to clarify when treaty benefits are appropriately granted to opaque Non-CIVs, using the two models described above and taking into account the Discussion Draft’s policy considerations. Each of the basic approaches are further described in turn, below.

### 4. Granting Treaty Benefits at the Level of the Non-CIV (the “Direct Benefits Approach”)

...
Under the first approach, governments should consider providing treaty benefits at the level of the Non-CIV in appropriate circumstances. In most cases, where a non-CIV has sufficient connection to its jurisdiction of residence any concerns about inappropriate tax planning should be alleviated for the reasons provided below. Additionally, this approach is administratively simpler than an approach based on the treaty entitlement of the Non-CIV’s investors, especially when it has a large number of investors.

In this regard, question 23 of the Discussion Draft asks:

**SUGGESTION THAT A “SUBSTANTIAL CONNECTION” APPROACH BE ADOPTED**

23. Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

The premise of the “substantial connection” approach is that a Non-CIV that is established for legitimate business purposes will normally develop a substantial presence in the jurisdiction where it is domiciled. Thus, a sufficient connection to the jurisdiction of residence will provide evidence of the non-tax reasons for establishing the Non-CIV. Consequently, a Non-CIV with a substantial connection should be entitled to the benefits of the treaties negotiated by its jurisdiction of residence.

**4.1 Suggested Approach**

With respect to the application of the PPT, we suggest that a Non-CIV should be entitled to treaty benefits when:

- the Non-CIV is established for commercial reasons; and
- its activities (or those of a related entity in the same State) have a substantial connection to its State of residence.

When a Non-CIV is established for valid commercial purposes and has a substantial connection to its State of residence, **there should be a presumption that one of the principal purposes of that Non-CIV’s organization is not to obtain treaty benefits.**

**4.1.1 Commercial Reasons for Establishing Non-CIV**

Non-CIVs are established for many commercial purposes. Indeed, several of the Pension Funds that have signed this letter have regional offices across the world, and we expect this trend will continue. As examples, we outline below the primary commercial reasons that a Pension Fund may establish a regional investment platform or a holding company, and the type of factors considered in determining the location of these Non-CIVs.
4.1.1.1 Regional Investment Platform

A Pension Fund might establish a wholly owned regional investment platform to provide:

- Greater connectivity with local markets and underlying investments in nearby jurisdictions;
- Concentration of certain asset management activities in a region to gain efficiency and scale;
- Access to appropriately qualified personnel; and
- Time zone efficiencies.

A regional investment platform’s personnel also may have responsibilities including:

- Reviewing investment recommendations from the Pension Fund’s globally dispersed investment teams;
- Making investment decisions and monitoring investments’ performance;
- Undertaking treasury functions;
- Acting as board directors for entities in which the regional investment platform has invested;
- Maintaining the company’s books and records;
- Ensuring compliance with regional regulatory requirements; and
- Providing services to any additional regional subsidiaries of the Pension Fund.

Also, for various legal and business reasons, investments are sometimes segregated into multiple Non-CIVs that are resident in the same State. A regional investment platform may undertake most of the substantial activities in that State and provide services to the other entities. In such cases, a substantial connection of a Non-CIV to its State of residence should be established by reference to the substantial activities carried on by another related entity in the same State.

4.1.1.2 Holding Companies

Similarly, funds or other investors may establish holding companies to:

- Pool investors’ capital;
- Leverage the investors’ capital in order to finance the investments; and
- Segregate liability with respect to different investments.

In deciding on the location of a holding company intended to aggregate the investment of entities from a variety of jurisdictions, a fund manager, a direct investor or a consortium of direct investors takes into account various commercial considerations, for example:

- Political stability and the regulatory and legal system;
- Legal flexibility and simplicity that would facilitate co-investments;
- Flexibility to extract exit proceeds from sales of the portfolio;
- Access to appropriately qualified personnel; and
- Certainty about taxation of the holding company on disposal of its investments.
4.1.2 **Additional Guidance Needed**

The Commentary should provide additional guidance, through a number of examples, to clarify the application of the PPT to Non-CIVs. **This guidance should provide that, if commercial purposes exist for the organization and activities of the entity, a principal purpose of the entity is not to obtain treaty benefits even if the availability of treaty benefits was a consideration when selecting the location of the entity** (see Appendix A for detailed examples). The guidance should also cover situations where the entity is established in a State where the investor has a regional investment platform that carries on substantial activities.

Further, some governments may want to establish minimum substance criteria to address treaty shopping concerns, for example:

- A minimum required number of full-time employees located in the State with a minimum local payroll threshold to ensure that the employees are performing substantial activities;
- The existence of permanent business premises in the State; and
- The existence of third party transactions at the Non-CIV level (e.g., issuance of third party debt or equity interests, hedging transactions, etc.).

### 4.2 Tax Deferral Concerns

We believe that granting tax benefits at the level of the Non-CIV also should not raise concerns about tax deferral when the Non-CIV is owned predominantly by Pension Funds and other tax-exempt entities. Tax deferral is generally not an issue in the context of Pension Funds, because Pension Funds are often tax exempt in their local jurisdictions. We also note that many jurisdictions’ domestic laws include anti-deferral legislation that apply to taxable investors in Non-CIVs.

### 5. Treaty Benefits Based on Investor Residency (the “Proportionate Benefits Approach”)

If a Non-CIV fails the PPT approach, we suggest that, at a minimum, treaty benefits should be granted based on the benefits that investors in the Non-CIV would be entitled to if they invested directly. This approach would ensure that a Pension Fund is not penalized for investing in a Non-CIV.

#### 5.1 Suggested Approach

We suggest that this approach could be administered by allowing the Non-CIV to claim treaty benefits based on the rate(s) to which the entity’s investors would have been entitled if they had invested directly. We refer to this approach as the “proportionate benefits” approach.

We suggest that the proportionate benefits approach should apply where a Non-CIV is not treated as fiscally transparent and the PPT applies to deny treaty benefits. As illustrated in the example in section 3.1, we are concerned that an “all or nothing” approach to treaty benefits
would mean that a source State would apply its highest domestic withholding tax rate. Similar issues arise under the LOB rule because the derivative benefits test strictly requires that equivalent beneficiaries own, directly or indirectly, more than a certain percentage of the Non-CIV. If the high ownership threshold is not met under the derivative benefits test, we are similarly concerned that the highest domestic rate of withholding would apply to the Non-CIV, which is a severely punitive result.

The proportionate benefit approach would, instead, allow a Non-CIV to claim a rate of withholding that is a “blended” rate based on the rate(s) under the treaties between the source State and the States of residence of the investors in the Non-CIV. If an investor in the Non-CIV is also a Non-CIV, the availability of treaty benefits should be tested at the level of that investor under the PPT or LOB, as the case may be. If the investor qualifies for treaty benefits as tested under the PPT or LOB, then the rate determined for that investor should be based on the rate under the treaty between the source State and the State of residence of that investor. If the investor fails the PPT or LOB, then availability of treaty benefits should be tested at the level of the investors in that intermediary Non-CIV, and so forth.

The following example illustrates how the proportionate benefit approach could apply.

### 5.2 Example of Application of Suggested Approach

A Pension Fund, resident in State T, agrees to co-invest in an infrastructure project in State S with investors resident in States U (“UCo”) and V (“VCo”). For various reasons, the Pension Fund, UCo and VCo invest in an intermediary company resident in State R (“RCo”). The Pension Fund, UCo and VCo own 60%, 10% and 30% of the shares of RCo, respectively. RCo invests in a company resident in State S (“SCo”) that owns the infrastructure project. For commercial reasons, RCo is a corporate entity that is treated as opaque under the tax laws of States T, R, S, U and V.

Dividends received by RCo from SCo are exempt from withholding tax under the treaty between State R and State S. If the Pension Fund and UCo received the dividends directly, the dividends received from SCo would be exempt from withholding tax under the treaties between State S and States T and U. If VCo received the dividends directly, the dividends received from SCo would be liable to withholding tax at a rate of 5%.

Assuming that the PPT applies to deny treaty benefits on the dividends paid by SCo to RCo, this could potentially result in State S applying its highest domestic withholding tax rate, which could be as high as 30% in some States. Similarly, under the derivative benefits test in the LOB rule, RCo may be denied treaty benefits because not more than 75 per cent of its owners would be entitled to at least the same benefit had the income flowed directly to its owners. This is particularly punitive given that, in this example, the Pension Fund and UCo would be exempt from withholding tax if they had invested directly in SCo.
Under the proportionate benefits approach, we suggest that, in this example, RCo should be entitled to claim treaty benefits based on the rate(s) under the treaties between State S and States T, U and V. If we assume that SCo pays a dividend of $100 to RCo, the dividend should be liable to withholding tax of $1.55 (i.e., the amount of tax that would have been withheld if the dividend had been paid directly to the investors in proportion to their holdings in RCo).

This approach should address treaty shopping concerns by ensuring that investors cannot circumvent the application of withholding tax on amounts paid from the State of source. Further, this approach should be consistent with the intent of treaties to promote cross-border investment between certain States and help alleviate the potential disruption that the Action 6 Report may have on cross-border investing.

We recognize that this approach may be more complex to administer than the direct benefits approach; however, we believe that any perceived administrative complexity can be overcome. Changes could be introduced gradually to allow governments and industry time to develop the requisite resources to manage any additional administration.

5.3 Potential Issues and How to Address Issues

To make a proportionate benefits approach work, the Commentary and source States would need to provide additional guidance on three issues:

5.3.1 Issue 1: Determination of the treaty entitlement of the investors

Source countries would need to provide clear guidance regarding what documents the Non-CIVs must collect to establish the treaty entitlements of its investors.

We propose that self-certifications, such as those used under the OECD’s Standard for the Automatic Exchange of Financial Account Information in Tax Matters (commonly referred to as the “CRS”) or the U.S. qualified intermediary (“QI”) regime, are preferred over other means, such as certificates of residence. In addition, source countries would need to provide clear guidance about when and how that documentation should be provided to a withholding agent and/or the source country government.

The Discussion Draft states that governments have significant concerns about identifying investors in Non-CIVs. The complexity of investor identification depends on whether the Non-CIV is closely held or widely held, and whether the entity accepts investment from tiered funds

5 If the dividend of $100 was paid by SCo to the Pension Fund, UCo and VCo directly, SCo would have paid $60, $10 and $30 to the Pension Fund, UCo and VCo, respectively. The dividend paid to the Pension Fund and UCo would be exempt from withholding tax. The dividend paid to VCo of $30 would be liable to withholding tax of 5%, or $1.5.

6 More generally, the documentation requirements could look to the IRS Form W-8IMY and related documents as an example of how such a system might work.
or other intermediaries. Our discussion is limited to closely held investment entities and, in this context, our experience is that Non-CIVs already identify and gather substantial information about their investors for anti-money laundering, FATCA, and CRS purposes. If governments provide clear rules, Non-CIVs could also collect the required documentation regarding the treaty entitlement of their investors.

If a Non-CIV cannot adequately identify all of its investors, we suggest that unidentifiable investors be treated as not eligible for treaty benefits.

5.3.2 Issue 2: How withholding taxes are allocated to each investor

We understand that governments may be concerned that treaty benefits granted to the Non-CIV under this approach would be indirectly spread across all investors, some of which may not be eligible for treaty benefits. For commercial reasons, Pension Funds are equally interested in ensuring that each investor receives only the benefits to which it is entitled, and we believe that that a proportionate benefit approach can be structured to preclude the potential transfer of treaty benefits between investors.

Accordingly, we suggest that, if different investors are entitled to different treaty benefits, the withholding tax must be allocated among investors. This could be accomplished, for example, by stipulating contractually in the constitutive documents of the Non-CIV (or through partnership agreements) that the benefit of reduced withholding rates will accrue to individual investors according to their treaty entitlement, and that distributions by the Non-CIV will be adjusted to reflect the appropriate withholding.

5.3.3 Issue 3: How refunds could be granted if too much tax is withheld

A refund mechanism would need to be developed to address situations where too much tax is withheld by the State of source. We suggest that the refund should be granted directly to the Non-CIV to ensure that the Non-CIV is responsible for the appropriate allocation of the withholding tax among its investors.

5.4 Tax Deferral

As noted in section 4.2, we believe that granting tax benefits at the level of the Non-CIV should not raise concerns about tax deferral when the Non-CIV is owned predominantly by Pension Funds and other tax-exempt entities. However, if tax deferral is a general concern for governments under a proportionate benefits approach, or if a proportionate benefits approach is otherwise unacceptable to governments, then we suggest that an alternative approach, namely the “fiscal transparency” approach described below, could address this concern.

6. Coordinated Fiscal Transparency Approach
As an alternative approach to the direct benefits approach and the proportionate benefits approach, we suggest that governments could allow, or require, investors to treat Non-CIVs as if they were fiscally transparent under the tax law of the investor’s State of residence (the “fiscal transparency approach”). This approach is intended to apply regardless of the legal form of the Non-CIV and the traditional characterization of the Non-CIV as not fiscally transparent (or “opaque”) under the tax law of the investor’s State of residence.

The fiscal transparency approach is intended to expand the application of the provision described in paragraph 9 of the Discussion Draft (i.e., new Article 1, paragraph 2 of the Model Tax Convention) by treating more types of entities as fiscally transparent. New Article 1, paragraph 2 would grant treaty benefits to an investor that derives income through a Non-CIV under the treaty between the source State and the investor’s State of residence, as long as the Non-CIV is treated as fiscally transparent by the investor’s State of residence. As noted in paragraph 10 of the Discussion Draft, this provision ensures treaty benefits are granted in these circumstances whilst addressing the two tax policy concerns identified in paragraph 14 of the Report on Action 6, i.e., that non-CIV funds may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits and that investors may defer recognition of income on which treaty benefits have been granted.

As noted above, Pension Funds often invest in Non-CIVs that are typically treated as opaque because of overriding commercial reasons. Therefore, the new provision cannot be relied upon in many instances to provide treaty benefits. For this reason, we suggest that governments could allow, or require, investors to treat Non-CIVs as if they were fiscally transparent under the tax law of the investor’s State of residence. This would give rise to the following consequences:

- The amounts paid by the State of source to the Non-CIV would be treated as income of the investor in its State of residence (even though the cash may not be received by the investor and may be reinvested by the Non-CIV in other projects). This should address any tax deferral concerns of governments.

- The tax withheld from amounts paid by the State of source to the Non-CIV should be based on the rate(s) under the treaties between the source State and the States of residence of the investors in the Non-CIV.

In this regard, question 7 of the Discussion Draft asks:

**NON-CIV FUNDS SET UP AS TRANSPARENT ENTITIES**

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?
We propose below ways to address the key challenges of this proposed fiscal transparency approach. Similar to the proportionate benefits approach, we consider that any inherent complexity in this approach can be overcome and that changes could be introduced gradually to allow governments and industry time to develop the requisite resources to manage any additional administration.

The key challenges and proposed options to address these challenges are as follows.

6.1 Challenge 1: Treatment of the fund entity as fiscally transparent

This approach would require a coordinated response by governments to ensure consistent treatment of a Non-CIV as fiscally transparent by each investor’s State of residence. We suggest that jurisdictions could issue coordinated guidance (possibly through the OECD) agreeing to treat certain specified types of entities as fiscally transparent.

6.2 Challenge 2: Determination of the treaty entitlement of the investors

This challenge is largely the same as under the proportionate benefits approach, and similar models could be used to document the treaty entitlement of investors.

Again, if a Non-CIV cannot adequately identify all of its investors, we suggest that unidentifiable investors be treated as not eligible for treaty benefits.

6.3 Challenge 3: The administrative complexity of investors making claims for treaty benefits

We recommend reducing the administrative complexity of the fiscal transparency approach by providing relief from withholding at the time of payment ("relief at source"), rather than a refund system.

In a refund system, each investor must claim a refund from the source country for withholding on a payment that was made to someone else (i.e., the payment is made by the domestic withholding agent to the Non-CIV, rather than to the investors). Source countries would need to provide a clear documentation procedure for investors to establish that they are the ultimate beneficial owner of the payment or are entitled to a specified share of the Non-CIV’s profits through their equity ownership therein. In addition, investors would need to be credited with the withholding allocated to their proportionate share of the payment. The U.S. QI and non-qualified intermediary (NQI) regime are examples of such documentation procedures.

A refund system also presents the problem that investors may not have all of the information they need to support a refund claim. This can happen where the investor is relying on obtaining relevant information from a Non-CIV that is unrelated to the investor. As a consequence, delays in receiving timely information could result in slow or denied refunds claims.
A relief at source system avoids many of these complications, by requiring that the withholding agent to obtain the required documentation up front and withhold on that basis. Moreover, putting the liability for tax on the local withholding agent can better ensure that the local government has recourse to collect taxes owed and keep the administrative burden low for the tax administration.

Relief at source systems would reduce the government resources necessary to administer the system, but would still require a mechanism for investor documentation to be provided to the withholding agent to determine the applicable withholding. Again, the U.S. QI/NQI regime could serve as an example for this mechanism. We note that one potential benefit of this system is that it allows for harmonization of claims for reduced withholding provided under both income tax treaties and domestic law. For example, the U.S. system allows source country withholding agents to review one set of documentation when determining investors’ eligibility for both treaty benefits and domestic law withholding reductions such as the “portfolio interest exemption” (available to foreign lenders) and the sovereign immunity exemptions (i.e., under Internal Revenue Code section 892).

7. “Global Streamed Fund” Proposal

Finally, the Discussion Draft describes a suggestion of a “Global Streamed Fund” regime. In this regard, Question 24 of the Discussion Draft asks about the feasibility of this regime:

**SUGGESTION OF A “GLOBAL STREAMED FUND” REGIME**

24. Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for Non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for Non-CIV funds that cannot, for various reasons, determine who their investors are?
- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
- What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

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7 More generally, the Form W-8IMY and related documents could be used as an example of such a system.
7.1 Response

We acknowledge that addressing government policy concerns in a practical way for Non-CIV investment entities is difficult, and that there is unlikely to be a single approach that works for all Non-CIVs. In that context, we believe that the Global Streamed Fund proposal is an innovative approach that is worth exploring in more detail. However, this proposal would require further development and global consensus on its administration (from the perspective of the source countries, intermediary jurisdictions and resident countries). Also, whether such an entity would be commercially feasible still needs to be tested.

8. Conclusion

If government policy concerns prevent the adoption of either the (i) direct benefits approach and/or the proportionate benefits approach, or (ii) as a last resort, the expanded fiscal transparency approach, and treaty relief is therefore not available at either (or both) the Non-CIV or investor level, the result will be withholding at full domestic rates. We believe that this result is severely punitive to Pension Funds that invest through Non-CIVs for various reasons. Further, this result could potentially impact the availability of long-term institutional capital to investee States, and is detrimental to various non-tax related public policy objectives.

We strongly encourage the OECD to provide the additional guidance suggested above regarding the application of the PPT to Non-CIVs. In addition, we urge governments to include a discretionary relief mechanism in the final LOB and PPT provisions to allow a Competent Authority to grant treaty entitlement to a Non-CIV and/or its investors where it determines that such entitlement is consistent with government concerns and public policy.

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We are of course willing to further contribute to the matters brought forward by the OECD that are of interest to the Pension Funds and would gladly provide you with further input.

Yours sincerely,

[signed]  
Steve Bossé  
Vice President, Taxation  
Caisse de dépôt et placement du Québec

[signed]  
Jacquelyn Colville  
Chief Financial Officer  
Alberta Investment Management Corp.

[signed]  
Kristina Fanjoy  
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Canada Pension Plan Investment Board

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Hersh Joshi  
Vice President, Taxation  
Ontario Teachers’ Pension Plan Board

[signed]  
Serena Lefort  
Head of Tax  
OMERS

[signed]  
Neil Marcovitz  
Vice President, Tax  
British Columbia Investment Management Corporation

[signed]  
Jean-François Ratté  
Vice President, Taxation  
Public Sector Pension Investment Board
Example 1

Background

- A Non-CIV (the “Fund”) is structured as a fiscally transparent partnership. The Fund is established to invest in a portfolio of existing and unrelated trading businesses. The Fund is marketed to pension funds, sovereign wealth funds, other institutional investors and high net worth individuals.

- Investors resident in different jurisdictions, including Pension Funds, invest in the Fund. The Fund’s investment strategy is not driven by the investors’ tax position, but that it will invest in businesses to increase their value and then realize this value via an exit from the investment.

- The Fund’s investments in target businesses are made through a group holding company, RCo, established in State R. The primary reason for the establishment of the holding company is to leverage the investors’ capital to finance the investments. The bank providing
the finance requires that lending is made to the holding company so that it can take security over the investment portfolio.

- In deciding on the location of the holding company, the fund manager takes into account various commercial considerations, for example:
  - Political stability, and the regulatory and legal system;
  - Legal flexibility and simplicity that would facilitate co-investments;
  - Flexibility to extract exit proceeds from sales of the portfolio;
  - Access to appropriately qualified personnel; and
  - Certainty about taxation of the holding company on disposal of its investments.

- In making the decision to locate the holding company in State R, the fund manager considered the existence of benefits under the tax conventions between State R and the states in which the target investments are resident.

**Consideration of the PPT**

The fact that the fund manager considered the existence of benefits under the tax conventions should not, of itself, be sufficient to trigger the application of paragraph 7 (i.e., the PPT). The purpose of tax treaties is to provide benefits to encourage cross-border investment. Therefore, to determine whether paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, if RCo’s investments are made for commercial purposes consistent with the investment mandate of the Fund, it should receive treaty benefits.
Example 2

Background

- A Non-CIV (“RCo”), resident in State R, is a wholly owned subsidiary of a Pension Fund resident in State T. RCo operates exclusively to earn income for the benefit of the Pension Fund. RCo acquires and manages a diversified portfolio of private market investments located in countries neighbouring State R to generate a long-term investment return.

- The commercial reasons for RCo being established in State R include:
  - Greater connectivity with local markets and underlying investments in nearby jurisdictions;
  - Concentration of certain asset management activities in a region to gain efficiency and scale;
  - Access to appropriately qualified personnel;
  - Its economic, legal and political stability; and
  - Time zone efficiencies.

- RCo’s personnel have responsibilities including the following:
  - Reviewing investment recommendations from the Pension Fund’s globally disbursed investment teams;
  - Making investment decisions and monitoring investments’ performance;
  - Undertaking treasury functions;
  - Acting as board directors for entities in which RCo has invested;
  - Maintaining RCo’s books and records;
- Ensuring compliance with regional regulatory requirements; and
- Providing services to any additional subsidiaries in State R.

- One of RCo’s investments is a 40% interest in a company resident in State S (“SCo”), in respect of which it receives annual dividends.

- Under the convention between State R and State S, the withholding tax rate on dividends is reduced from 30% to 5%. Under the convention between State T and State S, the withholding tax rate on dividends is reduced to 10%.

- In deciding to invest in the company resident in State S, RCo took into account the treaty benefits on dividends under the tax convention between State R and State S.

**Consideration of the PPT**

The fact that RCo considered the existence of benefits under the tax convention between State R and State S should not, of itself, trigger the application of paragraph 7. The purpose of tax treaties includes providing benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, having regard to all facts, it is not reasonable to deny RCo the benefit of the tax convention between State R and State S.
Example 3

Background

- A pension fund, resident in State T, indirectly holds an investment in an infrastructure project in State S. The pension fund co-invests with other institutional investors, which are resident in States U and V, in the project through an intermediate vehicle resident in State R (the “Fund”). The pension fund holds a 20% interest in the Fund. The investors provide both debt and equity financing to the Fund.

- Under the convention between State R and State S, the withholding tax rate on dividends is reduced from 30% to 5%. Under the convention between State T and State S, the withholding tax rate on dividends is reduced to 10%. Under the conventions between State S and States U and V, the withholding tax rate on dividends is reduced to 5%.

- In determining which jurisdiction to locate the Fund, the investors took into account a range of factors including State R’s tax convention network, and the certainty with regard to the tax treatment of interest and dividends, which is a commercial consideration given the scale and long term nature of these investments.

Consideration of the PPT

The investors considered the existence of a benefit under the State R-State S tax convention with respect to interest and dividends, but this alone would not be sufficient to trigger the application of paragraph 7. The intention of tax treaties includes providing benefits to encourage cross-border investment. Therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. If a vehicle is
established for purposes of providing finance for an infrastructure investment project, then after consideration of the facts and circumstances, it would not be reasonable to deny treaty benefits to the intermediate vehicle.
April 22, 2016

Tax Treaties, Transfer Pricing and Financial Transactions Division
OECD/CTPA
OECD Headquarters
2 rue André Pascal
75116 Paris
France

Re: Treaty Entitlement of Non-CIV Funds

Ladies and Gentlemen:

We welcome the opportunity to submit comments regarding the circumstances in which a non-CIV fund should be entitled to claim tax treaty benefits, and to address questions raised in the March 24 discussion draft.\(^1\) Cleary Gottlieb represents private funds and other enterprises and organizations interested in the BEPS project, and tax policy generally, but this letter is submitted in our individual capacity, and not on behalf of the firm or any of its clients.

We support the policy objectives underlying Action 6. We commend the working group for striving to develop rules that are practical, administrable and fair. We believe that this is an achievable goal. Appropriately designed standards would foster fairness and efficiency without creating opportunities for abuse. Our concern is that rules that are drafted too broadly could have damaging effects for sound business practices that are not undertaken for tax avoidance purposes. The diversity of non-CIV funds will make it difficult to rely on a single ‘one size fits all’ approach. If guidance is formulated with too broad a brush, it could unfavorably affect a wide range of uncontroversial arrangements, and could unnecessarily restrict access to an important investment class for a broad group of institutional investors including pension funds, sovereign wealth funds, tax-exempt investors and others.

\(^1\) Public Discussion Draft, “Treaty Entitlement of Non-CIV Funds” (March 24, 2016).
We share many of the concerns raised by other commentators. This letter is intended to supplement suggestions that you have received from other sources. We have endeavored to avoid restating arguments that have already been made effectively and at length, and to find something new to say.

A. SUMMARY OF RECOMMENDATIONS.

1. A fund should not be considered to be engaged in impermissible treaty shopping to the extent it can establish that its investors would have qualified for comparable benefits if they had received the relevant income directly.

2. The fact that a fund is not tax-transparent, or that it makes use of intermediate holding companies that are not tax-transparent, should be irrelevant to the determination as to whether those entities are engaged in impermissible treaty shopping.2

3. The potential to realize deferral benefits similarly should be irrelevant in most cases.

4. Transition relief should be provided for investments that have been structured in good faith in reliance on current law.

B. DISCUSSION.

1. Overview.

Non-CIV funds are a very significant asset class. The value of investments held through such funds is well in excess of one hundred billion Euro, and probably a multiple of that amount. Rules that would make it difficult or impossible to claim treaty benefits in respect of income derived by such funds would significantly reduce the attractiveness of this asset class, without producing commensurate policy benefits.

OECD member states have long recognized the important role that pooled investment vehicles can play in a diversified portfolio.3 Non-CIV funds serve essentially the same purposes for a different investor base.

Many such funds require investors to make long-term commitments (e.g., 5 to 10 years) and have significant restrictions on transfers, and limited or nonexistent redemption rights. This

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2 This letter uses the term “fund” to refer both to funds and to intermediate holding companies through which funds hold investments, and refers specifically to CIVs and non-CIV funds only when there is a reason to distinguish between them.

means that such funds typically are not suitable for small investors that require access to liquidity. The characteristics that make non-CIV funds unsuitable for most small investors can enable these funds to make investments that are illiquid, difficult to value, distressed, or otherwise in need of a turnaround.

A significant proportion of the investor base for non-CIV funds consists of pension funds for government and private company employees, sovereign wealth funds, and other long-term institutional investors. Many such investors are precluded by prudential, regulatory or tax requirements from conducting business activities, or holding control positions, directly. Those investors effectively are restricted to holding non-traditional assets only through a pooled investment vehicle.

Many of those investors would be exempt from taxation, or would qualify for treaty benefits, if they received income directly rather than through a pooled investment vehicle. A non-CIV fund should not be considered to be engaged in impermissible treaty shopping because it structures its affairs to try to replicate the treatment that its investors would have received had they made the same investments directly.

Some commentators have noted that a non-CIVs fund’s ability to engage in treaty shopping can be limited by business, regulatory and reputational considerations.\textsuperscript{4} We would add that non-CIV funds clearly make use of entities organized in treaty jurisdictions for a variety of business, regulatory, financial, administrative and investor protection reasons.

A fund may hold assets through a holding company in a treaty jurisdiction to accommodate the needs of co-investors; to provide additional protection against liabilities associated with a distressed business; to streamline the process of claiming treaty benefits, and avoid the need to navigate the complex and inconsistent national rules concerning income derived through a partnership or other tax-transparent entity; for reasons of administrative convenience (for example, a fund that acquires businesses in France, Germany and Italy, and wishes to combine them under a single umbrella, may find it preferable to situate the holding company in the United Kingdom or Luxembourg); or because the assets came that way (see Example 2, where a fund acquires a multinational company that conducts activities through subsidiaries around the world).

2. Treaty benefits for qualified funds.

We believe the OECD should encourage member states to provide a workable mechanism that enables non-CIV funds to claim treaty benefits in appropriate circumstances. Commentators have suggested a variety of standards under which a fund that meets specified requirements would be considered not to be engaged in impermissible treaty shopping, and therefore could qualify for treaty benefits without regard to the identity or tax status of any

\textsuperscript{4} See, e.g., comments on the Action 6 discussion draft submitted by the British Private Equity and Venture Capital Association (17 June 2015) at 2.
particular investor. We believe that appropriately designed standards would foster fairness and efficiency without creating opportunities for abuse.

Of the various possible standards, we would prefer an objective test (e.g., a fund will not be presumed to be engaged in impermissible treaty shopping if it can establish that more than half of its investors would have qualified for comparable benefits on a direct investment) over a subjective test. The disadvantage of a subjective test is the potential for uncertainty. For example, if a principal purpose test is applied without objective criteria and detailed examples, the inability to anticipate how the rules will be applied in a particular case will make it difficult for investors to plan effectively, and for tax administrators to prevent evasion.

A fund needs to be organized somewhere. As noted above in Part B.1, the choice of a jurisdiction for an investment or holding vehicle will be influenced by a number of factors, but will also necessarily be influenced by tax considerations (which may involve potential tax benefits, or may simply involve avoiding “blacklists”). In choosing between a treaty jurisdiction and a non-treaty jurisdiction, the potential availability of tax treaty benefits inevitably and appropriately will be a relevant consideration. Countries with extensive tax treaty networks market themselves to prospective investors on that basis.

If the working group wishes to include a principal purpose test as a permissible alternative for determining whether a non-CIV fund is entitled to treaty benefits, we recommend that it provide either safe harbor rules or detailed examples illustrating the application of the test, in order to provide guidance for taxpayers and tax administrators. These rules or examples could provide that a principal purpose will not be deemed to exist if the availability of treaty benefits is not expected to reduce the aggregate tax burden borne by a fund and its investors by a significant amount (e.g., by more than 10%), as compared to a hypothetical direct investment.

We believe that the right comparison for a principal purpose test is to a hypothetical direct investment made by the fund’s investors, rather than to an investment made by the fund through a non-treaty vehicle. If the principal purpose inquiry stops at the level of the fund or intermediate entity, a tax treaty jurisdiction will often produce significant savings (as compared to a hypothetical investment through a non-treaty vehicle) in any case where the fund expects to derive income that would be subject to source-country withholding tax in the absence of treaty benefits. A principal purpose test that stops at the level of the fund will not accurately identify abusive behavior, and instead risks subjecting investors to tax costs that they would not have incurred on a direct investment. Investors care deeply about maintaining parity of treatment between direct investments and indirect investments through a fund; for this reason, they routinely demand that fund managers contractually promise to structure investments and organize funds in a way that preserves this treatment.


This recommendation is intended to make the point that determining whether a non-CIV fund qualifies for treaty benefits does not need to be an all-or-nothing proposition. If a member
state does not provide workable rules to enable a non-CIV fund to qualify for treaty benefits with respect to all of its income, the result should not be that none of the fund’s income qualifies for such benefits.

This would be a profoundly unfair result in cases where a significant proportion of a fund’s investors would not have been subject to source-country tax if they had received the fund’s income directly. If a fund does not qualify for treaty benefits with respect to all of its income (because a country has not prescribed standards for this purpose, or because the fund does not satisfy those standards), it should at least be able to claim benefits in respect of the proportion of interests in the fund that is owned by qualified investors. Thus, if 50% of a fund’s investors would be entitled to treaty benefits or another comparable exemption, then 50% of the fund’s income should qualify for treaty benefits.

4. **Recommendation 2: tax-transparency.**

The discussion draft asks whether treaty rules concerning income derived through a partnership or other fiscally transparent entity should be relevant in determining the treatment of non-CIV funds. We think those rules should not be relevant in determining whether a non-CIV fund is engaged in impermissible treaty shopping for purposes of Action 6.

The purpose of treaty provisions dealing with income derived through fiscally transparent entities is to identify the beneficial owner of that income.

As discussed in the Examples included in Appendix 2, countries apply varied and inconsistent domestic-law rules for determining whether an entity is fiscally transparent, and whether income derived through such an entity qualifies for treaty benefits. Some countries (and some treaty partners) have well-developed and effective rules, and significant experience in applying those rules; others do not. Except in the most straightforward fact patterns (investors concentrated in one jurisdiction; investments made in a very limited number of other jurisdictions), it would be extremely difficult to structure a non-CIV fund to qualify for tax-transparent treatment in multiple source and residence countries. It should not be necessary to do so.

5. **Recommendation 3: deferral.**

The discussion draft also asks about the applicability of rules that are designed to prevent taxpayers from exploiting differences in the treatment of income in different countries (including, in particular, that a taxpayer should not be entitled to claim treaty benefits in respect of an item of income based on its country of residence while simultaneously taking the position

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5 See, e.g., new Article 1(2) of the Model Tax Convention, as set out in Action 6.
that the income is not subject to current tax in that country because it was derived through an offshore company).\textsuperscript{6}

We believe that it is unnecessary and inappropriate to assign significance to the possibility that an investment in a non-CIV fund could produce inappropriate deferral benefits, for several reasons.

First, many countries already have specific anti-deferral rules targeted at offshore funds, like the U.S. PFIC rules and the U.K. offshore fund rules. Residence country rules are a much more effective way to address deferral concerns relating to offshore funds, and member states should be encouraged to adopt these rules if they have not already done so.

Second, the hypothetical potential that some taxable investors could exploit differences in national tax rules to realize deferral benefits represents a particularly inappropriate criterion for denying treaty benefits to non-CIV funds, since many such funds are owned predominantly by tax-exempt investors that do not benefit from deferral.

Finally, several factors specific to non-CIV funds create strong incentives to distribute income currently, and reduce the practical risk that investors will realize inappropriate deferral benefits. Fund performance and a manager’s incentives are driven by the amount and timing of cash returns. Managers are motivated to return cash to investors as quickly as possible and not to defer investment returns until a later date. In addition, taxable investors in non-CIV funds have a strong aversion to incurring tax liability in respect of a fund’s income in advance of the receipt of cash distributions.

6. **Recommendation 4: transition relief should be provided.**

Investors and funds have relied on existing law and tax treaty provisions in structuring their investments. It may not be possible to easily adapt existing arrangements to bring them into compliance with any new requirements. Disallowing treaty benefits could produce significant unfairness and market disruption, particularly in cases where the arrangements were not intended to facilitate inappropriate claims to treaty benefits, and don’t raise significant concerns about base erosion or profit-shifting.

An appropriately limited transition rule would allow time for existing arrangements to be adapted to the new requirements or sold. This would preserve fairness and impartiality without compromising the policy objectives underlying Action 6.

\textsuperscript{6} Discussion draft at para. 4.
Member states should be encouraged to adopt transition rules that allow a significant period—such as ten years—for existing arrangements to be adapted to the new requirements.

* * * * *

We hope that you find these comments helpful. Please let us know if you have questions concerning our recommendations, or any other aspects of this letter.

Very truly yours,

James A. Duncan
Jason R. Factor
Daniel I. Hanna
Appendix 1: Responses to Questions

Questions related to certain aspects of the derivative benefit proposal

8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty shopping and, if yes, why?

Institutional investors include pension funds, sovereign wealth funds, insurance companies and other sophisticated long-term investors. The term may include taxable entities or other funds. Some of these investors may be less likely to use a fund to engage in treaty shopping, for reputational reasons or because they would have qualified for comparable benefits on a direct investment.

We recognize that adopting a clear definition of “institutional investor” may be a difficult task. An alternative approach would be to require a minimum proportion of a fund’s beneficial owners (e.g., 51%) be entitled to equivalent benefits if they had invested directly (or be exempt from tax). This would allow the OECD to definitively conclude that funds eligible for this rule are owned predominantly by investors “entitled to benefits that are at least as good as the benefits that might be claimed by” the fund.

Investors should not be worse off by investing in a fund and should not be subject to tax for doing so. We believe that this approach would be more faithful to the goal of minimizing double taxation, and of maintaining neutrality between direct and indirect investments for investors, while simultaneously addressing treaty shopping concerns.

Questions related to the identification of the investors in a non-CIV

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

In many non-CIV funds, investor turnover is significantly restricted by tax, legal and business considerations, and the fund interests tend to be quite illiquid; transfers are individually negotiated, bespoke transactions often subject to the discretion of the fund manager. Other funds, with structures and asset mixes more similar to those of a typical collective investment vehicle, may have more frequent turnover. But even in these cases, the makeup of a fund’s ownership typically remains fairly stable; the types of investors acquiring interests in the secondary market are similar to those who make the initial investments (e.g., a substantial percentage are tax-
exempt, or eligible under tax treaties). A transfer of interests in a fund does not usually result in a meaningful change in the makeup of the fund’s investor base.

14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

This fact pattern—a fund that cannot identify its owners—will be increasingly rare following the implementation of the FATCA, CRS and UBO rules. If the concerns relate to arrangements that were put in place before those regimes entered into force, perhaps they can be addressed by appropriate transition rules.

But the fact that some funds may not be able to determine the tax status of their beneficial owners should not affect the treatment of other funds that can.

Many funds will typically know the general makeup of their investor base, and can request additional information on a case-by-case basis to comply with regulatory or legal requirements. Funds may be subject to contractual obligations to maintain confidentiality and not to unnecessarily disclose the names of beneficial owners, to the extent consistent with applicable law.

Funds routinely collect and retain information about their ultimate beneficial owners. A fund will collect and retain information from its direct investors when it admits the investor into the fund. The operative fund documents nearly always vest the fund sponsor with broad authority to request additional information on an ongoing basis, as needed to comply with legal and regulatory requirements.

To the extent there are any concerns about the ability to identify every beneficial owner in a fund, the concern is primarily related to a small subset of a fund’s investor base. Investors may participate in a fund through other pooling vehicles. Concerns regarding investor identification are mostly relevant to a small subset of these pooling vehicles: the vehicles that pool the capital of a diverse group of investors (e.g., a fund of funds), rather than those with a defined investor base.

In cases where investor identification is necessary, there are practical ways to address the issue. In the case of vehicles that pool the capital of a diverse group of investors, the direct investor should be able to provide the information necessary for the fund to determine its treaty eligibility (i.e., a general percentage breakdown of the direct investor’s owners that are treaty residents versus non-treaty residents). Some OECD member states already require a similar determination to be made for local law and treaty eligibility purposes. Funds typically have the authority to request this information under their operative documents, and have done so in the past. A well-designed rule would permit a fund to abide by its confidentiality and other
contractual obligations, while providing source countries with the information needed to establish treaty eligibility in a cost-efficient manner.

Direct transfers generally should not affect a fund’s ability to identify its ultimate beneficial owners, given the fund manager’s involvement in those transfers. In the case of indirect transfers of interests in investors that are pooling vehicles, a fund could adopt simplifying measures (i.e., it could calculate its treaty eligibility without this subset of investors, or it could periodically require the direct investor to inform the fund of such transfers).

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

Funds routinely collect information on each investor’s tax status, tax classification, tax identification number, tax residence, classification for FATCA purposes and, in some cases, similar information in respect of the investor’s indirect owners.

Funds also require information about beneficial owners for purposes of anti-money laundering (“AML”) and know-your-customer (“KYC”) rules, which include collecting governmental identification cards of individual owners, organizational documents of entities, identifying significant beneficial owners of pooling vehicles (and, in some cases, requesting a list of the direct investor’s owners or—where the investor itself is subject to AML or KYC rules—requiring the direct investor to represent that its owners have complied and will comply with applicable AML and KYC rules). In cases where a direct investor is unable to reveal the identities of its owners, some funds require a general breakdown of each indirect owner’s tax residency for treaty eligibility purposes, and require further representations from the direct investor for purposes of AML and KYC rules.

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

This information is in most cases sufficient. The most difficult cases arise in the context of a small subset of the fund’s investors that pool the capital of various owners, and where the information is not obtained as part of the AML or KYC diligence process. These investors may be unwilling or unable to provide specific identifying information about their owners. A fund may not ultimately need this information; it may be able to establish its treaty eligibility solely by reference to its other investors. In cases where the fund needs additional information, it can
usually ask the direct investor to provide the fund with the information necessary for the fund to determine its treaty eligibility (i.e., a general percentage breakdown of the direct investor’s owners that are treaty residents versus non-treaty residents). Most direct investors will comply with such requests.
Appendix 2: Examples

Facts

Fund raises money from institutional investors resident in a dozen countries (the “investor countries”) and uses the proceeds to make investments in a dozen countries (the “source countries”). There typically will be some overlap between investor countries and source countries: for example, a German investor may hold an interest in a UK fund whose assets include interests in German companies.

Fund is organized in a treaty jurisdiction. The proportion of its income that depends on the availability of treaty benefits often will be comparatively small (for example, if Fund expects income to consist predominantly of capital gains that are not subject to source-country tax).

Income from each source country can be treated in a variety of ways.

- The country may provide an exemption that is available to non-resident investors generally (for example, an exemption from withholding tax on interest paid on specified kinds of debt obligations). Alternatively, the country may tax all income in that category without exception (for example, income from real property). In either of these cases, the tax characteristics of particular investors, and the question whether they derive income directly or through Fund, won’t affect the amount of source-country liability.

- The country may provide one or more exemptions that depend on the residence and tax status of the recipient (e.g., under a bilateral tax treaty, under rules applicable to sovereign investors, pension funds or charitable organizations, or because a resident of the country is not subject to a tax on foreign investors).

- Tax treaty benefits may be a primary or secondary source of comfort. For example, if there is uncertainty concerning the availability or duration of the generally applicable exemption, the availability of treaty benefits may provide a helpful backstop.

Most (and perhaps in some cases all) of the investors in Fund would qualify for an exemption from most source-country taxes if they received income directly. Assume that 95% of the investors would qualify for an exemption with respect to at least one source country, and 80% would qualify for an exemption with respect to all 12 countries.

The composition of the investor group that would have been able to receive income free of tax, and the basis for the exemption, will vary from country to country.

Many of the countries have rules under which an investor can qualify for an exemption if it derives income through a partnership or other tax-transparent investment vehicle. The rules vary in small and large respects from country to country. Each country applies its own rules for determining whether an entity is tax-transparent, and, if so, whether income derived through that
entity will be treated the same as income received directly. Some countries may have effective and practical rules dealing with tax-transparent entities; in other countries, the level of practical experience may be limited or nonexistent.

**Example 1**

Fund wishes to acquire interests in a French company ("SA") and a Russian company ("OAO"). France generally taxes dividends paid to nonresident nontransparent investors at a 30% rate; Russia taxes such dividends at a 15% rate. Most of the investors in Fund would qualify for an exemption or reduced rate if they received dividends from SA and OAO directly. Fund organizes Luxembourg holding companies to acquire the companies in the expectation that, subject to the satisfaction of required conditions, the companies will be able to receive dividends from SA free of French tax under the EU parent-subsidiary exemption, and dividends from OAO at a reduced rate under the income tax treaty between Russia and Luxembourg.

The use of the intermediate holding companies allows Fund to maintain neutrality for its investors between a direct investment and an indirect investment through Fund.

A standard that disallows treaty benefits in their entirety because a minority of investors would not have qualified for such benefits in respect of a direct investment, would unfairly penalize the majority of Fund’s investors.

A standard that defers to tax transparency rules under local laws would run afoul of the principle of neutrality: the rules differ significantly from country to country and some countries may have no rules at all, which will mean increased costs and uncertainty for Fund and its investors.

**Example 2**

Fund acquires and takes private a UK company ("PLC") that was previously listed and widely held. PLC is principally a holding company that conducts operations through subsidiaries around the world: its income consists of dividends and interest received from those subsidiaries. PLC has claimed treaty benefits in respect of that income for many years. If it matters, the investors in the Fund would have qualified for similar benefits if they had received the same income directly.

PLC’s entitlement to treaty benefits in respect of income received from its longstanding subsidiaries should not be affected by the change of ownership.
To: Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA

By email: taxtreaties@oecd.org

22 April 2016

CREFC Europe response – OECD BEPS Action 6 discussion draft: Treaty Entitlement of Non-CIV Funds

Introduction

The Commercial Real Estate Finance Council (CREFC) Europe is a trade association promoting a diversified, sustainable and successful commercial real estate (CRE) debt market in Europe that can support the real economy without threatening financial stability.

CREFC Europe is the voice of the CRE finance industry in Europe, representing banks, insurance companies, fund managers, and others who provide or intermediate the provision of debt to real estate businesses, as well as advisers, consultants and others with a stake in this sector.

Investment into CRE is critical for any economy. Such investment provides accommodation for businesses and other occupiers that is fit for purpose, offering them the flexibility to suit their premises to their changing needs and changing economic conditions. By providing much of our built environment, the CRE industry represents a critical component of the real economy, delivering important socio-economic benefits to communities as well as opportunities for productivity gains for business.

As a capital intensive and long-term business often involving very large, valuable and illiquid assets, CRE is dependent on the ready availability of credit. This dependency is driven principally by the very different risk and return expectations (and hence cost) of different types of capital. The capacity of CRE to generate long-term, stable cash flows in the form of rental income is well suited to the use of debt. Accordingly, the CRE finance industry plays an important role in supporting CRE investment and the wider economy, by providing the debt that helps fund investment in the built environment.

We are aware of the submission of the British Property Federation (BPF) in response to the Discussion Draft which highlights concerns as to the potential adverse impact of the current proposals on investment in CRE. We generally support the BPF’s comments regarding the limitation on benefits (LoB) and principal purpose test (PPT) approaches.

However, the current proposals are also of direct relevance to many CRE debt providers, particularly given the recent – and rapid – diversification in CRE debt markets, with new lenders, principally CRE debt funds, emerging. This diversification is to be welcomed from a policy as well as market perspective, and should be protected: excessive CRE debt exposures concentrated in the banking system has been a significant problem for many countries in recent years.

Although many of the points made by the BPF are equally relevant to such non-bank CRE lenders, we set out below some additional comments relating specifically to (i) CRE debt funds and (ii) securitisations of commercial mortgages (commercial mortgaged-backed securities or CMBS), particularly in relation to the PPT (question 25).
Key points

1. **Treaties must continue to support cross-border investment**: A well-functioning tax treaty regime is critical in ensuring that capital can flow cross-border efficiently to suitable investment opportunities. That is good both for savers all over the world, and to support productive investment. A balance therefore needs to be struck between ensuring that treaties cannot be easily abused and facilitating commercial cross-border trade and investment. However, on the basis of the current drafting of the LoB and PPT provisions, and related commentary, we are concerned that the rights of bona fide non-CIV funds to treaty benefits could be adversely affected.

2. **Tax neutrality is not the same as tax abuse**: For both CRE debt funds and securitisations, tax neutrality is a necessary feature of their structure. For debt funds, this is because investors expect to be in no worse a position through investing in a fund that they would be had they invested directly. For securitisations, the objective is to ensure that cash receipts from investments are available to investors (the bondholders) to the maximum extent possible. Where such non-CIVs operate cross-border, the availability of treaty benefits can be an important element of achieving that tax neutrality – and will therefore influence the decision as to where to locate an asset-holding company. Seeking tax neutrality in this context is consistent with, and not an abuse of, OECD tax treaty principles.

3. **Very low risk of tax deferral for CRE debt funds and CMBS**: In relation to both debt funds and securitisation, the risk of tax deferral is very low. This is because for both types of entity there is a commercial imperative to pass on income and gains to investors within a short time frame. For debt funds, this is because of the importance of achieving the internal rate of return (IRR) promised to investors; for securitisations, timely payment to note holders is important to support the ratings required for the notes.

4. **Certainty is key**: Both debt funds and securitisation require certainty as to their tax position at day one. For securitisations, this is particularly important given rating requirements and the deliberately inflexible and ‘automated’ structure on which they rely. As far as the PPT rule is concerned, the OECD commentary needs to include clear, straightforward, unequivocal guidance as to the application of the rule to non-CIVs, accompanied by realistic examples to provide taxpayers and their advisers with the required certainty.

5. **There is no “one-size fits all” approach for non-CIVs**: The number and nature of the questions included in the Discussion Draft highlight the challenges in crafting a single workable safe harbour for a “good” non-CIV. In relation to the PPT rule, we welcome the OECD’s willingness to consider adding “one or more examples” to the Commentary: given the different features of particular types of non-CIV, we would recommend that the OECD include specific examples for debt funds and securitisations, as well as for real estate funds.

A similar point arises in relation to the proposed LoB provision: it may be that more than one non-CIV carve-out is needed, given the differences between particular types of investment vehicle. This is particularly the case for securitisation, where a derivative benefits test would be impossible to meet as a practical matter, because of the listed and traded nature of securitisation bonds.

6. **Safe harbour for “widely held” funds**: We agree with the BPF that an investor in a widely held fund will not have the power to influence the structure or investment of a fund for their own tax advantage – so the risk of treaty abuse in a widely held fund is negligible. However, it is important that any “widely held” test is not simply a matter of counting the number of investors. This is particularly important for funds that invest in CRE debt – such funds tend to have a small number
of (typically institutional) investors, owing not to tax considerations but to the newness, limited scale and specialized nature of the asset class. Any test based on wide ownership should recognise the nature of the investors (are they themselves widely held?) and consider their ability to influence fund strategy (through control rights).

The PPT Rule - Private equity debt funds

An example relating specifically to the treatment of debt funds should be included in the commentary on the OECD. In response to question 25, we attach a proposed example at Appendix 1, and set out below the rationale underlying it.

1. Role of private equity debt funds

Until the financial crisis, the European CRE debt market was overwhelmingly dominated by banks. This led to concentration risk and a lack of transparency or liquidity that continues to afflict Europe’s financial system and economy. However, since the crisis, various kinds of CRE debt funds have emerged. Most originate or participate in new CRE loans, helping diversify CRE risk away from the banking system and providing a mechanism for non-originating capital to gain CRE debt exposure. Some specialise in junior or mezzanine debt, filling a gap in the higher-risk part of the market no longer attractive to banks that are (quite rightly) adopting a more conservative approach than they did before the crisis. Others tend to focus their lending activities on senior loans only. A small number have played an essential role in helping to resolve the pre-crisis legacy by acquiring portfolios of sub-performing or non-performing loans (NPLs) from banks or national asset management agencies.

The result of this rapid diversification is that the CRE industry is now able to access finance not only from the banks, but also from a range of new lenders and new vehicles for non-originating capital providers (including institutional and private equity debt funds). The existence of such debt funds complements bank credit for business and also helps to promote system resilience through diversification of lending sources.

For non-originating investors, the appeal of debt secured on real estate has long been recognised. Debt funds can be seen by investors, particularly institutional investors such as insurance companies and pension funds, as offering a competitive risk-adjusted return.

As is the case for private equity funds that invest in companies or real estate, the principal purpose of CRE debt funds is to allow investors, including major institutional investors, to benefit from the expertise of professional fund managers with significant experience of the CRE finance sector, in addition to the general benefits that arise from collective investment (namely, the ability to pool capital and thereby access investment opportunities which may not otherwise be available, as well as achieve risk diversification).

2. Common structure of private equity debt fund

By way of example, we summarise below a common structure used by debt funds. In many ways, it is not dissimilar to the structure of other forms of private equity or alternative fund.

Nature of fund: The fund itself will normally be constituted as a fiscally transparent partnership, as is common in the funds industry generally. Its investors will normally be a mix of institutions (insurance companies and pensions funds), sovereign wealth funds and high net wealth individuals.
Nature of Investors: Institutional and sovereign wealth fund investors may invest directly in the fund, or through intermediate companies (depending on their preferred investment strategy). In general, most debt funds currently have a small number of such investors (usually less than ten) and there is limited trading of fund interests: generally, the investor base of a particular fund is stable.

The nature of these types of investors is such that they would, were they to lend directly, generally be eligible for treaty benefits, or tax exempt (such as pension funds or sovereign wealth funds). However, given that investors are likely to be from a number of different jurisdictions, it is likely that each would be eligible under a different treaty.

Investment Decisions: The fund’s investment strategy - the type and nature of loans it intends to make (including any geographical and/or sector restrictions) – will be set out in the fund’s prospectus (and detailed in the partnership agreement). The investors and the fund adviser/manager will be unrelated (save to the extent the adviser/manager or its staff co-invest in the fund to align interests), and the adviser/manager will have discretion in selecting suitable investments within those restrictions.

The fund will invest in loans – either through originating loans to CRE borrowers, or acquiring loans from existing lenders (either as part of primary syndication or subsequently in the secondary market). These loans are generally acquired to hold to maturity (although certain strategies, including NPL investment, where active management, restructuring, enforcement or disposal may be likely). Its investment strategy, as detailed in the fund’s partnership agreement, will be outlined in the fund prospectus.

Making investments – use of SPVs: In general, loans will be made not by the fund itself, but by one or more corporate special purpose vehicles set up by the fund. This in part reflects how the underlying CRE debt market works. Borrowers typically expect to deal with corporate lenders (and this is reflected in market-standard loan documents). Using a corporate vehicle (Holdco) means that investors can be insulated from certain legal risks by virtue of the resulting “corporate veil”. Certain jurisdictions may have specific regulatory requirements which need to be met for an entity to be allowed to lend into the jurisdiction. Setting up a Holdco as lender therefore offers significant commercial benefits, as it is that company (not the fund - and accordingly not the (passive) investors) that will apply for all relevant regulatory consents and licences.

In addition, some, but not all, debt funds may wish to enter into joint ventures or use leverage as part of their investment strategy in respect of some or all of their loan investments – linked to achieving a particular IRR for investors. Where leverage is used, the lender providing that financing will generally want specific security over both the underlying (loan) asset being financed, and the entity that holds it. Using a Holdco facilitates the provision of acceptable security by providing an effective ring-fencing around the relevant asset.

Where a debt fund sets up a Holdco, it is common for the Holdco to be funded by a loan from the debt fund.

Returns on capital invested: The investments made by the fund will generate income for investors (primarily in the form of interest on the underlying loans and any fees). The capital provided by investors, which will be used to make loans to borrowers, will be repaid out of the repayment proceeds paid by borrowers (although where a borrower prepays a loan, the principal received may be reinvested, if the prepayment is in the first couple of years of the fund).

Fund performance, as is the case for other non-CIV private equity funds, is driven by financial performance, measured by the IRR, which looks to both the timing and amount of investor cash
receipts. Fund advisers/managers receive a fee that will generally include a performance-linked element (which is triggered once investors have received a specified IRR – a so-called hurdle). As a result, there is a clear and strong commercial incentive for funds (far outweighing any possible tax deferral benefit of retaining cash in the structure) to pass investment profits to investors when they arise – to meet IRR targets and as a result for managers to be in a position to be able to start accruing the performance element of their fee.

3. Importance of treaty benefits

In common with other collective investment vehicles, a debt fund will look to use, so far as reasonable, a tax efficient structure to holding its investments, so as to optimise returns to investors. In some ways, the aim is to get as close as possible to the tax position that the ultimate investors would have been in if they had directly made the relevant investments. As a result, treaty benefits are needed to ensure that an additional layer of taxation does not arise merely because the investment is through a fund.

The availability of treaty benefits is important to the fund in relation to its investment holding structure in two specific ways:

(a) interest payments from borrowers to Holdco; and

(b) dividends and interest payments made by Holdco to the fund itself.

*Treaty benefits re investments:* Looking first at interest payments from borrowers to HoldCo, the loan market works on a presumption of gross payments (in that lenders expect to receive interest free of withholding, and borrowers expect to pay the net interest only (i.e. without having to “gross up” for any shortfall resulting from withholding tax). As a result, loan documentation generally contains market-standard provisions designed to allocate the risk of withholding tax as between (different types of) lender and borrower, with some loans prohibiting assignment to a new lender who would trigger a withholding obligation.

Where loans are cross-border, the treaty status of both the current lender and any potential future lender in respect of the loan is therefore of direct relevance to the parties when deciding to transact. If withholding tax were to apply to interest payable to Holdco, then, unless the borrower is required to gross-up its interest payments, investors would incur an additional level of tax which would not apply if they lent directly. If the borrower is required to gross-up, then the borrower’s effective cost of funds increases, as compared to the position under a direct loan made by a treaty-protected lender. Further, where Holdco is looking to buy (rather than originate) its interest in the loan, the fact that the borrower may have to gross-up payments to Holdco could preclude Holdco from making that investment in any event.

Similarly, if there is uncertainty as to whether withholding applies (for example, because a debt fund lender needs to apply to the competent authorities for discretionary relief), the allocation of risk between lender and borrower whilst that application is pending could also impact the economics of the loan.

Ultimately this could mean that the funding currently being provided by debt funds ceases to be viable economically, impacting the availability of finance from this increasingly significant sector of the CRE finance market and reducing effective competition in the debt market by placing market-based finance provision (through such funds) at a tax disadvantage relative to more traditional sources of finance. We can see no policy justification for such an outcome.
Importance of avoiding double taxation: The availability of treaty benefits means that the likelihood of investors suffering additional levels of tax to that which would have been payable had they invested directly is reduced: the availability of treaty benefits is therefore important in ensuring tax neutrality of funds. As a result, although a number of factors will influence the choice of jurisdiction of Holdco (such as the legal regime, political stability, investor familiarity, flexibility to extract proceeds from piecemeal realisations of the portfolio), it is extremely unlikely in practice that, where a fund has a number of possible jurisdictions to choose between, it would locate Holdco in a jurisdiction that was not suitably treaty-protected.

In addition, as highlighted above, the availability of treaty benefits is also important for the fund to be able to lend in the first place.

Tax is thus a factor that is considered when the fund sets up its investment holding structure. That is not to say that access to treaty benefits is a principal purpose of non-CIV funds. Rather, treaty benefits are a necessary condition for allowing investors to access the investment opportunity offered by CRE debt funds without suffering an additional layer of tax. The need for tax neutrality is a requirement arising from the use of a non-CIV fund and its underlying investment strategy, not a main purpose of the arrangement; this is not a case involving treaty shopping. The fact that the availability of treaty benefits is considered by the fund, among other factors, does not render its behaviour abusive.

The PPT Rule – Securitisation

We consider that the OECD should include within its guidance on the PPT an example relating specifically to the treatment of debt funds. In response to question 25, we attach a proposed example at Appendix 2, and set out below the rationale underlying the drafting of that example.

1. Role of securitisation

Securitisation companies are recognised by regulators as an essential part of well-functioning capital markets. Encouraging the re-emergence of a European securitisation market is a key aspect of the European Commission’s Capital Markets Union Action Plan. In particular, the European Commission has stated that it sees securitisation as “an important channel for diversifying funding sources and enabling a broader distribution of risk by allowing banks to transfer the risk of some exposures to other banks, or long-term investors such as insurance companies and asset managers”.

In the context of CRE debt, securitisation serves a useful role, both in terms of transferring credit risk arising from CRE lending away from the banking sector; and also in providing long-term investors with the opportunity to have access to a diverse pool of assets in a form which can be lower-risk than the underlying loans. Various post-crisis challenges have limited the growth of a significant, sustainable CMBS market in Europe, but it is important to ensure that the regulatory and tax environment does not unnecessarily create additional barriers to the evolution of such a market.

2. Common structure of CMBS

By way of general background, a bank or other originating lender may make use of securitisation after making various loans to third party borrowers, based in a number of different jurisdictions.

The Issuer: At a certain point, the origination lender determines to securitise the loans. A securitisation company (Issuer) is established by a corporate services provider as an “orphan” on terms that the shares are held on a charitable trust. The directors of the Issuer will in many cases be provided by that corporate services provider. The orphan nature of the Issuer is effectively a rating agency requirement, as it supports the “insolvency remoteness” of the Issuer (i.e. the Issuer will not be affected should the originator become bankrupt).

The Issuer issues notes through the capital markets to a wide pool of third party investors including asset management firms, hedge funds and institutions. There are likely to be a number of different classes of notes (i.e. senior and more junior tranches), most or all of them rated, with the most senior class typically being rated AAA.

Most if not all of the notes are listed on a stock exchange, allowing them to be traded on the secondary market. As the notes are held through a clearing system, the Issuer is unlikely to have any actual knowledge of the identity of its investors.

The pool of loans: The proceeds of the notes issue will be used by the Issuer to acquire the relevant pool of loans from the originating lender. The loans to be acquired will have been determined by the originating lender having regard to rating criteria, so that the notes can get the desired ratings. Certain details of the loans to be acquired by the Issuer will be made available to prospective note-holders in a prospectus.

The cash flows: Interest and principal received from borrowers will be applied in paying interest, and repaying capital, on the notes in accordance with a pre-agreed contractual priority of payments. In general any money received by the Issuer from its investments will be paid out within a short period to noteholders, after meeting expenses (in practice this is usually within 14 days and almost invariably within the same quarter (i.e. 90 days)) – although the Issuer may be required under the securitisation arrangements to retain an amount by way of profit and/or for reserves against specific credit-related risks (again, to satisfy rating agency requirements). In some jurisdictions (including the UK), the ability of the Issuer to qualify as a securitisation company is dependent on all cash receipts being paid out within a particular period of receipt.

The principal activities of the Issuer: Activities such as collecting payments from borrowers, making payments on the notes and any related administration are delegated to agents, and a loan servicer is appointed to act on the Issuer’s behalf in respect of loan portfolio surveillance and dealings with borrowers. The Issuer itself is designed to be passive, with all its principal activities contracted out to third party service providers. Further, the parameters within which the Issuer (and its agents) can act will be prescribed by contracts entered into on day one – the arrangements that support the structure are in effect regulated by the requirements of the rating agencies and as a result the Issuer has very limited discretion in relation to managing its assets.

3. Importance of treaty benefits

Although many securitisations are domestic (i.e. originating lender, Issuer and borrowers are all resident in the same jurisdiction), cross-border securitisation can and does also occur – and it can be a policy goal to promote it, as for example in the context of European Capital Markets Union.
As stated above, the loan market works on a presumption of gross payments. As a result, none of the loans would be subject to withholding tax when made, either by virtue of a specific domestic withholding exemption or because of a treaty claim by the lender.

As is the case with debt funds, when structuring a securitisation, the focus is on achieving tax neutrality so that interest and principal received on the underlying loans are available to the fullest extent possible to service the notes (after meeting known third party expenses). By buying notes issued by the Issuer, investors acquire an interest in the cash flows generated by the underlying loan pool.

If the Issuer were not entitled to treaty benefits in respect of the acquired loans and borrowers applied withholding tax, the additional cost would impact the assumed securitisation cash flows and thus also the rating of the notes and ultimately the viability of the securitisation itself. Even material uncertainty at the outset of a securitisation regarding the Issuer’s ability to obtain treaty benefits in respect of a particular loan would probably prevent the loan from being securitisable. Uncertainty in this context would include the situation where the Issuer would need to apply for discretionary relief under a treaty.

The reason why certainty on tax is needed is because the rating process involves the Issuer receiving legal opinions on certain matters, including tax. The tax opinion would address the ability of the Issuer to receive interest on the securitised loans free of withholding. If the opinion is qualified in any way because of any uncertainty as to, say, the Issuer’s entitlement to treaty benefits, the rating agencies will in effect assume interest is received net of withholding. The cost of that withholding has a direct impact on the cash assumed to be available to service the notes, and so affects the ratings – and ultimately therefore the economics (and viability) of the transaction.

The purpose of securitisation is a commercial one: the transfer of risk to non-originating investors and the recycling of capital by the originating lender. In structuring the securitisation, tax is an important consideration, both at entity level (i.e. the tax treatment of the Issuer itself) and in terms of withholding tax. Tax neutrality is an essential element of the rating analysis and therefore of the structuring of the deal, not a main purpose of it. Similarly, investors expect limited (and known) tax leakage within the structure, and that the Issuer will be entitled to receive interest gross. Again, this does not mean that obtaining treaty benefits at Issuer level is a principal purpose of the arrangement.

Many jurisdictions provide a specific exemption from withholding tax for listed securities (for example, the quoted Eurobond exemption within the UK tax code), to encourage capital market financings. Given that withholding is generally dis applied in relation to both interest on CRE loans and interest on securitisation bonds, it is hard to see any policy rationale for denying treaty relief to securitisation issuers. The effect would simply be to make securitisation very difficult, contrary to policy objectives in many countries.

We would ask that the OECD provide a clear example of the application of the PPT rule to securitisations to provide the certainty required (including by rating agencies) to enable the securitisation market to function as intended.

The LoB Rule

We generally agree with the comments made by the BPF in its responses to the questions raised in the Discussion Draft. We have the following additional comments, reflecting specific concerns relating to debt funds and securitisation.
Questions 1 and 2: What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal? What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal?

CRE debt funds (in common with many real estate funds) typically have a small number of (mainly institutional) investors, often less than ten. That is a function of the newness, modest scale and specialised nature of the asset class, and has nothing to do with tax.

Any “widely held” test must take account of the nature of the investors (and not just the number), and “cliff-edges” should be avoided as regards any minimum. In particular, where investors would themselves be regarded as widely held, the fund should also be considered to have met the test.

We also agree with the BPF that regulation should not be a condition to treaty access.

Question 4: Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed.

As explained above, the risk of tax deferral is very low in relation to both CRE debt funds and securitisations, given the commercial imperative to pass money to investors promptly. In any event, the concerns about deferral may be best tackled through domestic rules enacted by individual states to address deferral by their residents (by taxing on a current basis (undistributed) income earned through an investment fund), that take account of the operation of their domestic tax framework and policy objectives (particularly if it is the case that member states take different views as to the risks from potential for deferral, which was suggested in relation to the 2010 OECD Report on granting treaty benefits to CIVs).

Question 9: Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

There is no “one-size fits all” definition of a non-CIV. There is a wide spectrum of funds that could be excluded from being able to benefit from tax treaties under the current proposed form of LoB in circumstances where there is no tax abuse. Therefore, we would ask the OECD to consider including within its non-CIV safe harbour different criteria or regimes, enabling different types of non-CIV fund to access treaty benefits.

This is particularly important for securitisations. Securitisations would be very unlikely to qualify for treaty benefits under the type of non-CIV provision being contemplated in the Discussion Draft, particularly as a securitisation company will generally have no information about its investors. In particular, as investors in a securitisation hold their economic interest by way of debt securities, the base erosion test is unlikely to be met; and any derivative benefits related criteria would be impossible to meet (the subject of question 8).

This would suggest that either securitisation companies are carved out specifically (in a way similar to that suggested for CIVs at paragraphs 35 or 42 of the draft commentary in Section A of the OECD’s Action 6 Final Report, subject to appropriate modifications reflecting the structure of such transactions (for example, the listing of its bonds and/or the existence of a particular securitisation regime within one of the Treaty States).
Question 14: How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

The comments made by the BPF in relation to question 14 (and also questions 15 and 16) apply equally to debt funds. We concur that a pragmatic approach needs to be taken here.

However, as stated above, securitisation Issuers and sponsors are generally unaware of the identity of their investors (who can change as notes are traded), and so would not be able to determine the tax status of noteholders. It is for that reason that exemption from withholding tax on interest on bonds issued on the capital markets is generally conferred by a specific domestic exemption (as is the case in the UK) such that treaty entitlement of noteholders is irrelevant in practice. It would seem both odd and inequitable for the ability of a securitisation entity to claim treaty benefits to be dependent on noteholders’ tax status.

Question 17: Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

Any intermediary entity should be able to claim treaty access if it is owned by a non-CIV which itself could claim treaty relief: i.e. the treaty eligibility of the fund itself would allow any intermediary entities which are controlled by it to access treaty benefits.

Question 24: Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on [it].

We agree with the BPF that a GSF regime should be an elective one, and that introducing such a regime could raise significant transitional issues for existing funds (and tax authorities).

We would be happy to discuss any of the points made above, or any queries relating to the examples below, at your convenience.

Yours sincerely

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Appendix 1: Debt Fund example

A non-CIV fund, structured as a fiscally transparent partnership, is established to invest in a portfolio of loans. The fund may invest in loans in order to benefit from a regular income stream in the form of interest receipts (whether by originating such loans or acquiring existing performing loans), or it may seek to invest in distressed or otherwise underperforming loans, in the hope of achieving a profit from a future repayment, restructuring or disposal of the loans.

The fund is marketed to pension schemes, sovereign wealth funds, other institutional investors and high net worth individuals, on the basis of a prospectus that will become the investment mandate of the fund. A variety of investors unrelated to the manager, and who may be resident in different jurisdictions, commit funds to the partnership without then knowing either the identity of the target investments or the specific jurisdictions in which the investments will be made (although the prospectus will set out the fund’s investment strategy and may therefore indicate a particular geographical, sector-based or other investment focus for the fund). The investment strategy of the fund is not driven by the tax position of the investors, but on the basis that it will seek to invest in a range of debt obligations offering a suitable return on capital. The fund manager (and its staff) may co-invest alongside third party investors to provide alignment of interests.

Debt investments are made through a holding company, RCo, established in State R. It is likely that the investments held through RCo will include debt investments from different jurisdictions, some of which may not impose withholding taxes in respect of income and gains arising from debt investments, as well investments in jurisdictions that do impose such withholding taxes.

There are a number of reasons for the fund to establish a holding company in order to make debt investments.

By establishing a corporate holding company to make investments, investors in the fund will benefit from the protection provided the limited liability afforded to the fund as shareholder in RCo. There may, for example, be regulatory requirements arising in the jurisdiction(s) in which loans will be made that make a corporate holding vehicle desirable.

In addition, borrowers typically expect to deal with corporate lenders. This is reflected in market-standard finance documents. Accordingly, the use of a corporate holding company facilitates both negotiations with new borrowers and the transfer of existing loans originated by other lenders on normal market terms.

In some cases, a fund may wish to leverage the investors’ capital in relation to all or some of its investments to enhance the return on capital (either at the outset of the fund or at a later stage to be determined). The use of a corporate holding vehicle provides the fund with increased flexibility to utilise external leverage as a component of its investment strategy. This is because a lender to the fund will typically prefer to lend to a holding company, as this facilitates the taking of security over both the investment portfolio and the share capital of the holding company itself. If the fund wants to retain the flexibility to use external leverage for some, but not all, of its investments, the fund may set up a series of investment-specific holding companies, each of which would hold separate investment portfolios, to simplify any such financing arrangements.

In deciding on the location of RCo the fund manager considers the legal regime, political stability, investor familiarity, flexibility to extract proceeds from realisations of the portfolio and tax considerations such as certainty around the taxation position of the holding company in respect of income from the portfolio and proceeds from the disposal of its investments (which includes considering the treaty position of RCo in relation to a likely range of borrower jurisdictions). These
tax considerations are taken into account as part of the decision but are one factor in a range of considerations.

In making the decision to locate the holding company in State R, the fund manager will have considered the availability of benefits under the tax conventions between State R and the states of residence of potential borrowers, but that alone would not be sufficient to trigger the application of [paragraph 7]. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not [paragraph 7] applies to an investment, it is necessary to consider the context in which the investment was made. In this example, in the absence of other facts and circumstances showing otherwise, RCo’s investments are made for commercial purposes consistent with the investment mandate of the fund, so it should receive treaty benefits. In summary, unless RCo’s investments are part of an arrangement, or relate to another transaction, undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the tax treaties between State R and any states which may seek to impose tax in respect of income or profits arising from RCo’s investments.
Appendix 2: Securitisation Example

LenderCo makes loans to unconnected borrowers located in one or more jurisdictions. LenderCo may be a bank or a non-bank lender. To remove risk from its balance sheet and recycle its capital, LenderCo wishes to securitise a portfolio of loans which it has originated. To facilitate the securitisation, a special purpose vehicle, SCo, is set up. As is common for securitisations, the issued share capital of SCo is held by independent shareholders to ensure that SCo’s solvency would not be affected by the bankruptcy of LenderCo. SCo is a resident of State S. LenderCo may be resident in State S or in a different state.

The decision as to where SCo should be resident is driven by State R’s securitisation and other relevant legislation, established credentials as a location for establishing securitisation companies, skilled and knowledgeable professional services market and tax considerations relating to obtaining certainty as to the tax treatment of SCo. These tax considerations include the comprehensive double taxation treaty network of State S, including its tax treaty with any state in which borrowers under LenderCo’s loans are resident.

SCo raises debt finance to fund its acquisition of loans from LenderCo by issuing bonds to third party investors in the capital markets. LenderCo may be required to hold a proportion of the bonds issued by SCo for regulatory reasons. The bonds are rated and listed on a recognised stock exchange. Investors’ decisions to acquire the bonds issued by SCo are not driven by the location of any particular investment made by SCo and SCo’s investment strategy is not driven by the tax position of investors (in fact, SCo has limited or no information about its investors, which will change as the bonds are traded). Subject to any special regime applicable for securitisation companies, SCo is taxed in State S on income earned and is entitled to a full deduction for interest payments made to investors. In addition, payments of interest on the bonds to investors by SCo can be made free of withholding tax under the tax laws of State S.

SCo uses the proceeds of the bond issuance to acquire the portfolio of loans from LenderCo. The portfolio includes loans made to borrowers resident in State R – these loans may in aggregate represent a significant proportion by value of the portfolio. SCo receives regular interest payments on these loans. Under the tax treaty between State R and State S, the withholding tax rate on interest is reduced from 30% to 0%: had LenderCo retained the loans, LenderCo would have been entitled to an equivalent reduction in withholding, whether under the applicable treaty with State R or under some other exemption.

In this example, merely reviewing the effects of State R’s tax treaty with State S on interest payments by the borrowers located in State R to RCo, or the fact that State S has a comprehensive double tax treaty network, would not enable a conclusion to be drawn about the purpose of the establishment of SCo by LenderCo.

The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, in order to determine whether or not [paragraph 7] applies to an investment, it is necessary to consider the context in which the investment is made. Assuming that SCo was established in connection with a genuine commercial decision made and implemented by LenderCo to securitise certain assets, and unless SCo’s investment in the loan portfolio is part of an arrangement, or relates to another transaction, undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R / State S tax convention to SCo.
Mr Andrew Dawson  
OECD  
Working Party 1.  
Centre for Tax Policy and Administration

By email: taxtreaties@oecd.org

22 April 2016

Our ref: WJID/SJC/MES

Dear Andrew,

**Treaty entitlement of non-CIV funds**

We welcome the opportunity to comment on this discussion document. Our comments are made from the perspective of the UK and from a standpoint of our experience working with investment fund clients that raise capital from and invest in all parts of the world.

In this letter we set out our comments on the main issues and then in the Appendix we answer the specific questions posed in the discussion document. We also believe that it is important to distinguish between the principles (i.e. what treaty benefits should be granted), and the collection mechanism which should be employed to collect taxes due, therefore we cover this separately below.

As the OECD’s Final Report into Action 6 of 5 October 2015 acknowledged (paragraph 14), non-CIV funds have an important role to play in providing a source of capital investment and their commercial investments have become increasingly international in recent years. Fund structures are designed to address a variety of commercial needs, including operational, legal and regulatory requirements.

Non-CIV funds are not a homogenous group of funds but rather a great variety of different types of funds, used for different reasons, with different investor profiles. We welcome this discussion draft as an attempt to enable non-CIVs and their investors to access treaty benefits. For ease, many of the examples used to illustrate our points refer to private equity industry; however, for the most part, these points apply equally to other types of non-CIV.

In order to enable treaty benefits to be made available, we believe that there need to be options to suit the different types of funds and their investors. Where a fund is either regulated or widely held we believe that this should be sufficient to address concerns of treaty shopping and permit the fund to access treaty benefits. However, these options will not be viable for all classes of fund and, therefore, where they are not in point, we believe that a solution such as the Global Streamed Fund regime proposed in the discussion draft would provide
a workable solution to enable qualifying investors to access treaty benefits, or, alternatively the variant of GSF set out below in this letter.

As regards treaty shopping, most non-CIVs and virtually all private equity funds are closed-end investment funds that pool capital and allow investors to diversify. As a result, they provide an important source of capital for investee companies. The investors come from a multitude of countries and have different tax attributes. The aim of funds, with respect to taxation, is to achieve fiscal neutrality, meaning that the fund itself does not add a layer of tax.

The proposals we make here could allow for the possibility of a non-CIV fund getting treaty benefits where some of its investors would not benefit from treaty rates if they were to invest directly into the same investments, however, this is no different to the situation where non-qualifying investors hold shares in a public or widely-held company which qualifies for treaty benefits when it invests outside its home country. (Often companies can benefit from a dividend and capital gains exemption and therefore they are not fundamentally different for tax purposes to a fund that does not pay tax. The position could be different in respect of other forms of income). The safeguard against this outcome would be the LOB rule could require a significant majority of the fund’s investor capital to come from treaty countries.

As regards tax deferral, many funds do not generally retain low-taxed or untaxed pools of capital or profit at the fund level, and, in any event, funds are often fiscally transparent partnerships, precisely to achieve the fiscal neutrality referred to above. Furthermore the financial incentives for the fund managers can be based on IRR calculations of money drawn from and returned to investors so there is no incentive to retain profits. For example, fund documentation often requires private equity funds to return all the proceeds of investment disposals promptly, and not retain any for reinvestment.

Non-CIVs share many of the characteristics of CIVs (using the definition in the OECD’s 2010 report on The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles). For example, private equity non-CIVs often have a broad investor base (50-500 investors in a single fund is typical), invest in a broad range of jurisdictions and industries and can be subject to substantial regulation. The main difference that is created by the CIV definition is the diversity of investments held, even though non-CIVs will often hold a reasonably diverse investment portfolio, such as investments in 15-40 companies once the fund is fully invested.

As an alternative to the proposals of the discussion draft, we suggest consideration be given to the following alternatives: the following approach as the basis for granting treaty benefits to non-CIVs:

1. Non-CIV funds that are widely-marketed should be included in the list of qualified persons under the new model Article X(2)(f) on page 21 of the Final Report. We comment on widely-marketed in the appendix to this letter; and/ or

2. Non-CIV funds that are regulated should be included in the list of qualified persons under the new model Article X(2)(f) on page 21 of the Final Report. We comment on regulation in the appendix to this letter; and/or

3. A modified version of the GSF approach is adopted. We comment on this more fully below. The major differences between our comments and the GSF relate to collection. In respect of accessing a treaty:

   (i) Qualifying non-CIV funds (see below for proposal on “qualifying”) should be included in the list of qualified persons under the new model Article X(2)(f) on page 21 of the Final Report.

   (ii) The ownership test in Article X(2)(e) and/or Article X(4) should result in a company being a
"qualified person" if at least a significant proportion (say 80%) of it is owned either by persons entitled to treaty benefits OR by qualifying non CIV funds.

(iii) As regards the PPT rule, we believe that it has the potential to create significant uncertainty. The possibility that treaty benefits can be denied where tax is only one of the principal purposes could, we believe, lead to tax authorities in different countries reaching different answers on the same facts. To mitigate this we would propose that the commentary includes a statement saying that if substantially the only outcome arising is tax neutrality, as discussed above, and not a "better than neutrality" outcome for a material element of the fund’s investors, then the PPT rule will not operate to deny treaty benefits.

Collection mechanism

We propose that the guiding principle should be to collect the correct amount of tax in each case and to maximise efficiency, recognising there is potential for considerable human effort to be duplicated many times over at huge financial cost.

As an illustration of the potential for duplication, consider a large investor in non-CIV funds, which has 282 active investments just in private equity funds, virtually all of which invest in multiple counties. If one quarter of those funds each invested in three investments in a single country, say the UK, then, if the collection mechanism didn’t contain steps to avoid duplication, it would be necessary for the UK tax authorities to consider and decide upon the investor’s treaty entitlement about 210 times. That amounts to answering the same question some 210 times. That human effort can be extrapolated across all the countries in which these funds invest. There is the potential to create an incredible amount of duplicated effort, involving cost for tax authorities as well as funds and investors, and we urge that avoidance of this be a guiding principle in the design of any collection mechanism.

We therefore propose the following in outline:

(i) In determining whether 80% (or the applicable threshold, if different) of investor capital is sourced from treaty countries, the fund manager would invite each investor to self-certify treaty entitlement with each relevant country. This could be done in a prescribed form, with compulsory filing of the same form with the relevant tax authority. In other words an investor would certify to a fund manager that they qualify for treaty benefits with countries A, B and C, and are subject to x%/y%/z% withholding tax on interest/dividends/royalties from A, and the relevant percentages for B and C. The investor would also send notice to each of A, B and C’s tax authorities of that certification.

The tax authorities could intervene within a prescribed time limit and file an objection notice with the investor and the fund manager, who would withhold application of treaty benefits pending final resolution of the dispute. For any country in relation to which the investor had not filed a certification with the fund manager, the manager would default to a no treaty benefits position in relation to that investor. It would be necessary to put timeframes in place to ensure that there are no significant delays and consider how often the fund would need to review its investor base.

(ii) Any tax withholds might be an obligation of the companies in which the fund has invested, e.g. on dividends paid to the fund. The data collected by the fund manager as above
would be notified to investee companies in a prescribed form, and within a prescribed timeframe and those companies would withhold accordingly. This avoids one layer of duplication in that each separate investee company would not repeat the exercise.

(iii) In the event withholding taxes were to apply, the same certifications provided by each investor would be used to compute the withholding. No material extra effort would be required. Each withholding agent, e.g. a dividend paying investee company, would collect the “blended rate” of withholding tax and pay it to the tax authority concerned.

(iv) Once an investor has notified one fund of its self-certified treaty status and copied that notification to the tax authorities concerned as described in (i) above, the investor could make the same certification (including notice of any tax authority objections) to other non-CIVs without also notifying the tax authorities concerned, in order to avoid duplication at the tax authority and minimise duplication for investors. There could be a time limit, e.g. a requirement to re-notify the tax authority every 3 years. We acknowledge that this is likely to be a time-consuming process the first time it is undertaken but believe that it will be a more manageable process going forward.

(v) If an investor in a non-CIV is itself a non-CIV or CIV, the investor would notify the non-CIV on a composite basis, having itself done the exercise in (i) to (iv) above. In other words if 50% (by capital) of the investor fund’s investors don’t qualify for treaty benefits with country A and so will suffer 20% WHT on dividends, 25% of the investor fund’s investors qualify under the country A treaty for 10% WHT on dividends, and 25% of them qualify for a 5% WHT rate, then the investor fund would report to the investee fund 50% as its treaty qualifying fraction and 13.75% as its country A dividend WHT rate.

We believe that these suggestions would result in the correct amount of tax being collected, with minimal duplication of effort.

An investor with 282 investments, discussed above, would determine a grid of its treaty entitlements once, and submit the same document to each of its funds. Each relevant tax authority would consider the investor’s position once, not the 210 times mentioned above (perhaps with a repeat every few years). Each fund manager would receive sufficient data to be able to tell each withholding agent (such as a company about to pay a dividend) the blended WHT to apply to that dividend, and if asked the same question by another dividend payer in the same country could just repeat the same answer. The information delivery could be part of standard fund joining documentation. In addition, if there were to be a condition of the fund distributing all its income on a current basis (as appears in the GSF proposal) that could be incorporated into this mechanism.

The GSF proposal requires the country where the fund is based (which may be difficult or impossible to identify in the case of a fiscally transparent partnership that is merely a contract to invest together and share profits, not a person or a taxpayer) to determine the applicability of a tax treaty between two other countries. That is complex and onerous, and the tax administration of the fund’s country may have no competence, authority or even wish to do this. Complex questions could arise in the case of disputes. As an alternative, the proposal we make above moves the responsibility for withholding tax to the payer and places the policing of each country’s tax in the hands of its own tax authorities.

There are undoubtedly complications inherent in any such proposal and we have discussed our views on these in more detail in response to the questions posed in the discussion draft. Our detailed response to these
questions is included in the attached appendix. We have not responded to all questions.

If you wish to discuss any of the points raised in this letter, please do not hesitate to contact either me (bdodwell@deloitte.co.uk), or Simon Cooper (sjcooper@deloitte.co.uk)

Yours sincerely

W J I Dodwell
Deloitte LLP
Concerns related to the LOB provision

1. **What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?**

Agreeing a specific threshold to determine whether or not a fund is “widely held” applicable to all states is likely to be challenging. We believe that it would be reasonable for funds to qualify for treaty benefits if they are either regulated, or widely-held. As discussed further in our response to question 12, below, there are already regulatory regimes in place which require funds to be widely marketed in order to meet the requirements for that regime. Recognising that widely marketed does not necessarily equate to widely held, however, the requirement to widely market a fund recognises the commercial challenges in attracting funding which can limit the number of actual investors in a fund, which should not penalise those who have invested in good faith and should be eligible for treaty benefits.

De minimis limits could be included. However, such mechanical rules could arbitrarily work against funds, which have simply failed to commercially attract a number of investors. Any thresholds would need to be measured at the fund level, not at feeder fund level, to accommodate the commercial need for a single fund to comprise multiple partnerships, however that should be straightforward.

2. **What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to the distribution of interests (e.g. “know your customer” rules)?**

We believe that the best course would be to use existing regulatory frameworks, rather than attempting to define a new regime. The European Union’s AIFM (Alternative Investment Fund Managers) regulatory framework would be a good example. AIFM applies to regulate alternative investment funds (‘AIFs’), which are collective investment undertakings, not subject to the UCITS (Undertakings for Collective Investments in Transferable Securities) regime and applies to hedge funds, private equity funds, retail investment funds, investment companies and real estate funds, amongst others. It is an EU-wide harmonised framework and, as such, already has the support of a significant number of states.

Similar regimes could be considered for different markets. It should not be forgotten that there are a large number of funds which invest in companies and assets in Europe which are not marketed to investors in Europe. Therefore, any definition would need to encompass funds regulated in non-European jurisdictions. For USA funds, for example, the regulatory framework would be funds whose managers and the marketing of whose interests are subject to regulation by the SEC, under the US federal securities laws, including the US Securities Act 1933, the US Securities and Exchange Act 1934, the US Investment Company Act and the US Investment Advisers Act 1940. Marketing of private equity funds is typically done under the private offering exemptions of the 1933 Act especially Rule 506(b) of Regulation D.

3. **Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of
investors who would not otherwise be entitled to the same or better treaty benefits with respect to
income derived from that country. How would this treaty-shopping concern be addressed?

Fund managers commonly seek a large investor base with whom they can build long term relationships. Raising a fund which would only appeal to a group of non-treaty investors reduces the potential investor base significantly as it excludes the vast majority of institutional investors who do benefit widely from tax treaties, namely the world’s pension funds, the US endowment funds, most banks and similar institutions, insurance companies, sovereign wealth funds, etc. The costs of forming such a fund and complying with any relevant regulatory requirements could outweigh any tax benefits which would make it economically unviable. Furthermore, fund managers seek a mandate to invest in a reasonably diversified range of investments to maximise returns.

4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

It may be the case that investors are only taxable when they receive a distribution depending on, amongst other things, local tax rules, although as many non-CIVs are fiscally transparent partnerships, many investors will be taxed on earnings on an arising basis. Non-CIVs, such as private equity funds, generally repatriate proceeds as soon as possible. We do not believe that there should be mandatory distribution of earnings up the chain of intermediate companies; commercial reinvestment by a company owned by a non-CIV to grow shareholder value should be treated in the same way as companies generally. There could be other tax rules that apply (for example, controlled foreign companies legislation), but the ability to access a treaty should be the same.

Furthermore, we believe that there are many legal complications in requiring companies to distribute all their earnings. Distributions are governed by applicable company law and companies are generally required to have distributable reserves in order to permit earnings to be distributed, which may not tie in with the requirement to distribute all earnings. Further complications arise in relation to whether ‘earnings’ means tax or accounting profit, realised or unrealised, etc.

Alternatively, where mandatory distribution is not possible, investors could be required to treat the income of the company as a deemed distribution for tax purposes. This introduces further complications for funds and their investors when actual distributions are made. Furthermore, where there are no actual cash proceeds to distribute, as is often the case, investors will be required to make cash tax payments on their deemed distribution, without receiving a cash distribution with which to fund the payment of the tax.

5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

[No comment.]
6. One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

In practice, funds are generally structured to be as close to a direct investment as possible and merely seek tax neutrality. Tax in intermediate structures is acceptable, provided that the fund itself adds no further layer of tax. Companies in which the funds invest pay corporate taxes on their profits and in some intermediate holding companies there are often tax costs. Of course, companies seek to manage these as any company would, within the law, but they do that whether or not one of their shareholders happens to be a non-CIV fund. The critical aspect here is that intermediate companies should be granted relevant treaty benefits. Without that, the fund, as shareholder in a company, adds a layer of tax and investors will be incentivised to invest directly not through funds, which cuts off their access to diversification and cuts of the source of capital to the investee companies.

The funding of intermediate companies by debt is common – typically bank financing is borrowed by intermediate companies in order to deliver security packages demanded by banks. Related party loans are also used because non-CIV funds are usually required, or incentivised, to repatriate available cash to investors as soon as possible and debt allows simpler movement of money than equity/dividends, which are governed by company law restrictions, etc. Any concern about such structures being used for base erosion should be addressed under BEPS Action 4 – Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, or potentially Action 2 – Hybrid Mismatches.

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

Where a fiscally transparent entity has a diverse investor and investment base, there are undoubtedly practical issues in applying the tax treaties. There are technical issues, such as the absence of international uniformity in how different jurisdictions treat entities, for example a Dutch CV, or indeed a partnership formed in any country, may be treated as fiscally opaque by the Netherlands but fiscally transparent in other jurisdictions such as the UK. Any attempts to address this particular issue would need to be agreed between states as the solution would only be effective if it were applied uniformly by the state of source of the income and all the states of residence of the investors.

8. The rationale that was given for the above proposal refers to the fact that “investors” in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the
Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

In this context, “institutional investors” is a widely used generic collective term referring to pension funds, endowments (especially the US universities), insurance companies, banks, sovereign wealth investment funds, funds of funds, the state employees’ retirement systems of countries such as USA and The Netherlands, and public old-age pension systems of countries who fund those programs such as Norway and New Zealand, and similar investors. Therefore, these investors are generally not other non-CIVs apart from the funds of funds, and they are generally either taxable (such as insurance companies), or benefit from tax exemption (such as pension systems and sovereign states). In general it is true that these investors, who make up the largest part of the overall investment in Alternative funds, would be entitled to treaty benefits (or sovereign exemptions) if they invested directly.

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

There is no homogeneity in the variety of different types of funds which fall under the banner of “non-CIVs”, rather, they are the funds which are not Collective Investment Vehicles (‘CIVs’) as defined in the 2010 Report. Non-CIVs includes private equity funds, venture capital funds, hedge funds and investing in specific asset classes, such as infrastructure and real estate. They could take the form of a partnership, a company or some other type of entity. Establishing a definition which all states can agree on is likely to be challenging and is best left to bilateral agreement.

10. Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

[No comment]

11. What would constitute a “bona fide investment objective for the purposes of paragraph 17 above?

[No comment]

12. How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

The determination of whether a fund is “marketed to a diverse investor base” could follow existing regulatory regimes which already specify what constitutes wide marketing. An example of a widely marketed fund would be a UK Property Authorised Investment Fund (PAIF), which has to satisfy a genuine diversity of ownership condition, requiring it to be open to a wide range of investors, with no undue restrictions applying.

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?
The ownership of funds obviously varies, depending upon the type of fund. Many funds, such as private equity funds, do have very stable investor profiles. Typically, we might expect to see around 2% turnover of investors within a private equity fund in a year.

Other non-CIVs, such as listed closed ended funds, may be fairly regularly traded and so may see regular changes in their investor base.

14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

Although historically funds may have held less information about their ultimate beneficial owners, the level of regulation in place now, such as money laundering regulations and FATCA mean that funds, for the most part, do hold information identifying who their investors are. Where a fund does not hold such information on its investors who are funds of funds, the funds of funds themselves would reasonably be expected to hold this information and should be willing to provide it if investors wish to benefit from treaty rates. If the information cannot be provided it seems reasonable that such investors would not qualify for treaty benefits, as would be the case if those investors had invested directly, rather than through a fund.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standards rules)?

The information funds are required to hold on those who invest in them has changed over the years with increasing regulation, such as that mentioned above. More recent funds, therefore, generally hold more information on their investors and their ultimate owners. However, older funds may not have this information or the provisions in the fund documentation to require this information to be provided, or to allocate any resultant tax cost to the specific investor concerned. Therefore, some form of grandfathering would be helpful to those funds which are currently in the later stages of their fund life.

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If no, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rules? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

The most straightforward way for this issue of qualification for treaty benefits to be dealt with is to accept self-certification of their tax residence and entitlement to treaty benefits by investors. As an alternative to this, please see the collection mechanism proposed in our covering letter.

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries including multiple subsidiary entities (which is not the case of typical CIVs) how would the proposal
overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

Satisfying tax authorities that treaty benefits are not being provided to investors who do not qualify for them where there is a complex structure involving intermediaries is undoubtedly a more complex process. Under a Global Streamed Fund approach, where such structures exist, the authorities should look up through the structure to the top entity and if they are satisfied that that is a qualifying investor then eligibility for treaty benefits should be accepted.

Another parallel can be drawn with the French ‘3% Tax’ on the market value of real estate assets in France (governed by articles 990D et seq. of the French Tax Code), which imposes a tax on entities holding real estate in France unless they disclose their investors to the tax authorities and those investors are resident in ‘good’ jurisdictions (mainly, EU members or countries which have signed a tax treaty with France which include administrative clauses aimed at combating fraud and tax evasion). The mechanics of this require the entity to look up through the ownership structure, discounting de minimis holdings and entities in ‘good’ jurisdictions.

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

In order for states to be comfortable that funds are not being used for treaty-shopping in this respect, they would need to agree on a threshold that they find acceptable. Alternatively, treaty relief could be pro-rated to the percentage of qualifying investors in the fund. This would disadvantage qualifying investors in many existing funds as fund agreements do not usually permit the fund to allocate costs, such as withholding tax, to only those investors who do not qualify for treaty relief. It may be possible to change the fund agreement, but this would take time. As noted above, some form of grandfathering for older funds may be helpful in this respect.

19. One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

[No comment]

20. According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

[No comment – this is not an issue for us to determine.]
21. As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

A line has to be drawn at some point. We believe that the test should be to look through the transparent entity until a legal ‘person’ is reached. Under a Global Streamed Fund Approach it would be necessary to identify the ultimate investors.

22. The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included on the United States Model Treaty released on 12 February 2016. Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

[No comment]

23. Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

Transparent funds will often not have a tax residence so could not benefit from any such provision.

Global Streamed Fund

24. Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?

- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?

- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?

- What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

Whilst the proposal for a GSF regime is conceptual at present, we believe that there are elements which may work well for many non-CIVs, although it would create a significant administrative burden. We would
therefore see it as an elective regime; if the fund cannot or does not want to collect the information, it would not need to apply the regime and treaty benefits would not be available through this regime.

As mentioned in the covering letter, we are supportive of the concept of the GSF as an alternative to enable eligible investors to access treaty benefits where the fund does not already qualify by reason of being either widely held or regulated and elects into the GSF regime. However, we have also proposed an alternative to the GSF which would put the onus on the payer to deduct withholding tax on any payments to the non-CIV, at the rate applicable, to be agreed by the tax authorities of the state of source, based upon information provided to them by the fund.

**Requirement to distribute all income on a current basis**

See our response to question 4 above.

**Funds which cannot determine who their investors are**

Funds which cannot determine who their investors are would undoubtedly find the requirements of the proposed regime impossible to meet and are therefore unlikely to elect to be treated as a GSF.

For new funds, there are options for the fund to require investors to provide the information, or they will be allocated all of the cost of the tax withheld from their share of the fund income. As discussed above, for existing funds this is more challenging as the fund agreement may not permit withholding tax costs to be only allocated to non-qualifying investors, therefore penalising those who do not qualify for treaty relief.

**Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?**

The proposals could create a large amount of administration for both funds and tax jurisdictions of the State of residence of the fund. Furthermore, agreement would need to be reached between all states as to what supporting information the State of source should require/be entitled to support the level of tax required to be paid.

For many global funds, dealing with one jurisdiction could be beneficial and reduce some of the significant burden that would be placed on the fund if electing to be treated as a GSF. Furthermore, if agreement could be reached that any audit of a fund’s withholding agent status would be undertaken by the fund’s state of residence this would go some way to mitigate the additional administrative burden. We do have concerns that if states of source are permitted to conduct their own audits of a GSF’s withholding function, this could submit global funds to significant requests for information from a variety of jurisdictions, without consensus between those jurisdictions as to what information may be required and perhaps requiring funds to provide the same information to a number of different jurisdictions, in different formats. Permitting a GSF to deal with the tax authorities of its state of residence/state in which it is established would provide some certainty to the GSF that all their payments would be treated on a consistent basis.

Practical challenges could include how to determine the state of residence of the GSF, given that these could be fiscally transparent entities and may not, therefore, be tax resident anywhere. Possible options would include choosing the jurisdiction in which the entity was established, for example England for a English law Limited Partnership, as the jurisdiction of residence for the GSF, however, this would not always be obvious or practical as many jurisdictions may not have the administrative capacity to deal with a withholding regime for the number of GSF’s established there. An alternative could be to choose the jurisdiction in which a regulated manager of the GSF is resident. This introduces the additional complexity
of determining who the actual manager of the GSF is. For example, where a limited partnership is the
general partner manager of a GSF and is itself managed by an asset manager.

In some circumstances, there may also be issues in determining the state of source of income, where the
income flows through intermediate entities The logical answer would be the direct source of the income
flow, rather than an indirect one, e.g. from the top holding company.

It would also be necessary for states to agree what information investors would need to provide to prove
their eligibility for treaty benefits. One possible option is for states to accept self-certification of tax
residence and treaty entitlement by investors to the funds. We are aware of incidences where self-
certification is being considered where the investor is resident in a jurisdiction in which they are taxed on an
arising basis, for example. Another possible option, should states require certificates of residency from
investors, is for states to look at the period for which those certificates may be granted. At present, a
certificate will usually be granted for a period of 12 months. The administrative burden on large funds of
having to ask investors for supporting documentation every 12 months is significant, particularly as it can
often take up to six months following a request for a certificate of residency for it to be issued. In the case of
large institutional investors, such as pension funds, in particular, their country of residency is stable and
unlikely to change and therefore it would not seem unreasonable for them to be granted certificates of
residency for longer periods of time.

Furthermore, it is to be expected that there may be a delay in some cases between the timing of payment of
the tax by the fund and the timing of remittance of this tax to the State of source, which may be
unacceptable to some states. Agreement as to what would constitute an acceptable timeframe should be
reached at the drafting stage of this regime, together with a framework for dealing with disagreements
between states. Whilst mutual agreement procedures are already in place, it is generally understood that in
many jurisdictions these are already stretched to the limit.

We have set out our suggestions regarding an alternative collection mechanism in the body of our letter.

What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that
the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a
current basis?

Where the requirements of the GSF regime are not met, we would expect the consequences to be similar to
the consequences of errors under existing withholding tax regimes, with a requirement to correct the error
when identified and to possibly pay interest in respect of late paid tax. However, given the complexity of the
work required to be undertaken by funds under the GSF regime, we believe it would be reasonable for there
to be a transitional period where funds would not be penalised for errors resulting from the initial set up of
the withholding system.

Concerns related to the PPT rule

25. Commentators wishing to suggest new examples related to the application of the PPT rule to
common types of legitimate arrangements that are commonly entered into by non-CIV funds are
invited to do so. These examples should be brief and should focus on common transactions that do
not raise concerns related to treaty shopping or inappropriate granting of treaty benefits.
In applying the PPT rule, we believe that regard should be had to the overall structure of the non-CIV fund and its ultimate investors, ensuring that where the top fund is eligible for treaty benefits all intermediary entities are also deemed to qualify for those same treaty benefits.

26. Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

[No comment]

27. Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released in February 2016. If yes, what is the type of “statute, regulation or administrative practice” related to on-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

[No comment]

28. Please describe briefly any approach not already mentioned in this consultation document or in previous comments that could address concerns related to the way in which the new treaty provisions included in the Report on Action 6 may affect the treaty entitlement of non-CIV funds without creating opportunities for treaty-shopping or tax deferral.

[No comment]
Dear Sirs,

PUBLIC DISCUSSION DRAFT – TREATY ENTITLEMENT OF NON-CIVS

EFAMA¹ is grateful for the opportunity to comment on the OECD Public Discussion Draft related to concerns received by the OECD on previous discussion drafts related to the Report on Action 6, as to how the new provisions included in the Report on Action 6 could affect the treaty-entitlement of non-CIVs. We agree with the aim of the discussion draft to clarify any concerns in relation to the discussion concerning the treaty entitlement of CIVs / Non-CIVs.

General Remarks

a. Definition of non-CIVs

EFAMA understands that every investment fund that does not qualify as a CIV will be treated as a non-CIV. Accordingly, EFAMA believes that the starting point for any discussion regarding the treaty entitlement of non-CIVs lies in the clear definition of a CIV. All queries and concerns listed in the OECD Public Discussion Draft must be considered from this background.

EFAMA would strongly recommend to limit the definition of non-CIVs. Regulated investment vehicles that are sold to the public or that are open-ended and capable of having an unlimited number of investors should qualify as CIVs, irrespective of the legal form and the kind of assets the vehicle is invested in.

The 2010 CIV Report defines CIVS as investment funds that are widely held, hold a diversified portfolio of securities and are subject to investor protection regulation in the country in which they are established. However, no further definitions regarding “widely held” or “diversified” are provided in this context.

¹ EFAMA is the representative association for the European investment management industry. EFAMA represents through its 26 member associations and 61 corporate members EUR 21 trillion in assets under management of which EUR 12.6 trillion managed by 56,000 investment funds at end 2015. Just over 30,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 25,900 funds composed of AIFs (Alternative Investment Funds). For more information about EFAMA, please visit www.efama.org
EFAMA has concerns that the consequences of this lack of definitions are widespread feelings of legal uncertainty. This uncertainty is also reflected in the concerns that have been sent to the OECD in relation to the treaty entitlement of non-CIVs. Especially among the different states very deviating definitions regarding non-CIVs exist. EFAMA would therefore recommend to spend more time on clear definitions.

b. Concerns related to the LOB provision

Non-CIV funds provide a vital source of capital to companies, particularly to small and medium businesses, infrastructure projects, property development and other essential economic activities. They are formed for the purpose of providing access to investment opportunities for a variety of investors, typically institutional investors representing retirement plans and sovereign wealth funds that are invested for a variety of non-tax reasons.

Unlike CIVs, non-CIV funds are usually not sold to the public, and although some might be widely held, determining ownership is typically less difficult than for widely held and widely distributed CIVs. However, a lot of non CIV-funds have a geographically diversified base. Especially, due to this circumstance EFAMA would like to emphasize that’s it’s not automatically easier for non-CIVs to deal with a LOB clause just because they know their investor base.

EFAMA would strongly recommend to find solutions for the following difficulties which have to be faced by non-CIVs before implementing a LOB clause for non-CIVs:

- Different tax rates: In case the contracting states have deviating tax rates a recognition of the investors as equivalent beneficiaries might become difficult
- Special Purpose Vehicles (SPVs): Due to the often complex structures of non-CIVs that include several SPVs it is very likely that also non-CIVs will have difficulties to comply with the LOB conditions in practice. Investors, fund entities, fund SPVs and source country investments will frequently be in different jurisdictions. However, tax treaties regulate the outcome of bilateral transactions e.g. an investment by a resident of one country into an asset located in another country. This raises issues for non-CIV funds as to which bilateral treaty should in principle be relevant for any particular investment
- Deviating percentages of investors that are required to be resident of either contracting state

In addition, EFAMA would strongly recommend to put more attention on the actual structure of the investment vehicle rather than just implementing the same LOB clause for all CIVs / non-CIVs. In our view it is not appropriate to implement additional clauses, tests or rules for vehicles that are even not suitable for treaty shopping.

For example, in the course of the final report on BEPS 6 the OECD stated “...as a general rule, because the shares of publicly-traded companies and of some entities are generally widely-held, these companies and entities are unlikely to be established for treaty shopping.” EFAMA is of the opinion that there should be no distinction for investment vehicles that are publicly traded and that they should receive the same treaty access without having to fulfil further conditions.
In the context of LOB (US model) looking at the concept of widely held in a fund that is widely distributed (multiple jurisdictions, etc.), it is virtually impossible for funds to qualify under the various tests, including the "derivative benefits" test (which only applies to corporate entities), requiring 7 or fewer shareholders hold 95% of the shares in the relevant company. EFAMA would therefore argue that in case it is unavoidable to implement LOB tests they should include a more appropriate "equivalent beneficiaries" test for opaque funds.

EFAMA recognises that certain tax treaties and competent authority agreements assist “pension fund only non-CIVs”. We would support wider use of this approach as below but caution that this does not assist the majority of non-CIVs.

In the context of pension pooling vehicles income derived by a pension fund through an intermediate (non-CIV) fund should be subject to the withholding tax rate that would have applied to the pension fund in case of a direct investment.

We can illustrate this look-through approach in a simple example:

Pension fund P is resident in state X. P invests in state Z through a non-CIV in state Y. In the ultimate look-through approach, P would be entitled to treaty benefits between states X and Z as if P had invested directly in state Z, i.e. without interposing the non-CIV in state Y.

In our view this look-through approach is not quite the same as the suggestions regarding “non-CIV set up as transparent entities”. In the latter approach, domestic laws of “either Contracting State” determine whether a fund is transparent or not. In the look-through approach, we suggest however, a deemed to be transparent (which is the same in this context as deemed to be disregarded) concept in the model treaty, implying that domestic laws are not required to determine the transparency qualification.

The look-through concept implies that some “check-the-box” approach is required for the non-CIV in state Y.

Detailed answers to the questions raised by the OECD

EFAMA has reflected on the specific questions raised by the OECD. Our answers are shown below.

a. **Question 1: What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?**

As already stated in EFAMA’s “General Remarks” it is our belief that regulated investment vehicles that are sold to the public or that are open-ended and capable of having an unlimited number of investors should qualify as CIVs, irrespective of the legal form and the kind of assets the vehicle is invested in.

b. **Question 2: What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV...**
report (i.e. "regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV") as well as disclosure requirements relating to distribution of interests (e.g. "know your customer" rules)?

In a European context, we would suggest that both AIFs and UCITs as regulatory frameworks that would be acceptable to conclude that a fund is “regulated”. A UCITs would always meet our proposed definition of a CIV. We doubt that governments will be willing to provide LOB or PPT relief to all AIFs, for that reason alone and without closer examination of the other features of the fund.

c. Question 3: Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed? / Question 17: Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

EFAMA believes that it will be possible to design effective protection mechanisms for non-CIV funds, based on objective criteria on how a fund is marketed and its investment targets. In the time available for this consultation we have not been able to arrive at specific suggestions, but we strongly urge more time and deeper consultation between the OECD, governments and business.

d. Question 4: Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

No, in some countries (e.g. Germany and Switzerland) non-distributing vehicles are typically treated as transparent for tax purposes. Investors are taxed annually on the capitalization of the income of the vehicle. In some other countries (e.g. UK) the accumulated income in the fund is taxed at investor level.

Besides, there are also countries where non-CIVs do have an obligation to distribute its earnings. This suits the general objective of a (non-) CIV being used for pooling investment money with other investors, rather than investing directly which is usually less cost efficient. General mandatory distribution requirements would therefore in our view effectively address...
the concern of tax deferral. Please note however, that the mandatory distribution requirement should not be considered to be conduit activities, which would otherwise disqualify a fund as a qualified person in terms of the proposed LOB provision.

In a look-through approach, however, deferral of tax would not be relevant, as in a look-through approach the non-CIV would be disregarded. As a result, the source investment income (state Z) would be attributed directly to its investors (in state X).

e. **Question 6:** One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

We acknowledge the potential cascading taxation effect if various non-CIVs are involved. We believe that it makes logical sense for LOB clauses to look to the actual ultimate ownership of a fund complex. Again, for pension pooling vehicles in a look-through approach this potential issue would not be relevant as the non-CIVs would be disregarded.

f. **Question 7:** Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

EFAMA would suggest a deemed to be disregarded qualification provided for in the tax treaties rather than provided for in domestic laws as we acknowledge that changing domestic laws is unrealistic. Introducing a deemed disregarded qualification in the treaties would neither be simple, as it would be necessary to change the wording of several bilateral treaties. In our pension pooling example: treaty X-Z would need to embrace the disregarding of the non-CIV in state Y; state Y should accept the disregarding of the non-CIV in its state and consequently not claim treaty access requiring a modification to treaties X-Y and Y-Z. Technically, this would have to be arranged in the respective protocols to the treaties where usually execution arrangements are laid down.

A second practical difficulty of either a look-through approach or the “non-CIVs set up as transparent entity” approach, is accumulating claims of treaty benefits. If not properly prevented, both pension fund P in state X and non-CIV in state Y could claim treaty benefits in state Z. Anti-accumulation rules should be arranged for, also in the respective protocols. One could think of extending the current W-IMY for intermediary companies and the current W-8ben forms in a way that when claiming treaty benefits in state Z by P it should submit a W-
8ben representing that it claims treaty benefits in state Z and thereby disregarding non-CIV in state Y accompanied by a W-IMY signed by the non-CIV representing that it will waive rights to claim treaty benefits already claimed by P. The current W-8ben and W-IMY forms are mentioned as example; the OECD, should our approach be embraced, may prefer other identification forms.

Thirdly, the practical difficulty of source state Z to identify the investors in state X (and other states) of non-CIVs should not raise more difficulties than in today’s practice. Investors who currently invest via transparent entities also have to identify themselves to the source state via the mentioned W-8ben forms or similar forms whereby they have to confirm their residence, organisation type, taxable status etc. Regardless of how many investors invest via the non-CIV. We do therefore not recognize this mentioned difficulty as a new or unsolvable challenge but as an existing one which, although labour intensive, is quite effective even without TRACE being into force.

g. **Question 8:** The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

It is EFAMA’s understanding that commentators who raised these questions above were thinking of pension funds and state institutions. Such institutions normally have very good treaty status, and rightly demand that any pooled funds they use work in a way that does not negate that status.

**h. Question 13:** Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

Please note that there are many, widely differing, kinds of non-CIVs. However, in general the ownership of interests in non-CIVs should be more stable compared to the ownership of interest in CIVs because investors in non-CIVs will be professional investors looking for long term income and growth. Short-termism is atypical for this type of investor generally, but we also note that professional investors seeking short term returns would be better served by capital markets than by investment in a non-CIV, which are often illiquid, or at least offer less frequent redemption terms than CIVs.

i. **Question 15:** What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own
interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)? / **Question 16**: Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

When investing in a non-CIV fund (as for investment in a CIV) an investor needs to make several representations about its tax residence, regulation regime, its beneficial owner status, whether it is a pension fund, governmental organisation etc., its FATCA and CRS qualification, tax ID, etc. The information required is increasingly extensive, thus enabling the manager or administrator or custodian of non-CIVs to sufficiently identify its investors. In some cases, additional proof, e.g. about its organisation type or its supervisory body, is requested. In EFAMA’s experience it is generally possible to meet those requirements and we accept the fact that non-CIVs have to provide more information about their investors. In case investors are invested through nominees we would propose a solution where the nominee has to provide the investment fund with a spilt showing the percentage of the investors invested through the nominee that are treaty entitled.

**j. Question 23**: Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

We would be concerned that any such proposal should be implemented in a way that does not conflict with the existing legal freedoms of entities established in the European Union under EU law.

**k. Question 24**: Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
EFAMA recognises the inherent significant difficulty in designing - using only existing tools - a global tax regime that i) makes BEPS practically impossible in future whilst simultaneously ii) not in any way impeding the important role that non-CIVs play in flowing long term non-bank finance to the real economy. As such, we welcome innovative approaches that seek to resolve that difficulty in a new way.

We think the Global Streaming Fund proposal has potential to do just that, but would strongly prefer that the regime be elective, and in particular not mandatorily applied to existing funds that were designed around more traditional tax systems. Commenting on the assumption that this is the case, we respond to the detail questions as follows:

- We think it is possible in principle to apply the regime that do not make cash distributions of income. Widespread precedent exists for funds being required to computed their income on the appropriate tax-adjusted basis and reporting the per unit or per investor result so that the investor can be taxed accurately. There is even precedent for funds being asked to remit cash withholding tax, upon an annual accumulation of income, to the fund’s home tax authority.

- We think it is only practical at the current time to apply the GSF model to funds that have relatively limited turnover of investors, or are indeed fully closed ended. Funds that elected into the GSF regime would be those that either already have deep knowledge of their end investors (as might be usual say in a fund in the form of a limited partnership), or are willing to adapt their business model (as might be achievable with new funds purpose-designed for the GSF regime).

- The concept that tax be deducted by the fund domicile country and then remitted to the source country is central to the model. We agree it involves breaking new ground, but would see that as new political ground as opposed to being an operational or legal challenge to the industry. To the positive, the model does not require transmission of personal data (with the attendant privacy and cyber security challenges) in the way that say CRS does. We also note that this remittance of tax withheld has been done before, within the European Union, as part of the EU Savings Tax system.

- Funds already operate in an environment that entitlement to treaty relief may be a matter of tax technical interpretation. Where relief is claimed, funds already face the risk that the relief already given may be challenged - and restitution sought - by the source country tax authority.
Conclusion

EFAMA appreciates the very hard work of the OECD in pulling all the diverse views together and the wish to clarify any concerns in relation to the discussion concerning the treaty entitlement of CIVs / non-CIVs. However, EFAMA would like to remark that this topic is very complex. The time period of less than a month between the issuance of the discussion draft and the deadline to respond is short. EFAMA, as the representative association for the European investment management industry would like the ability to meet with members of Working Party 1 to present case studies and clarify the points being made here.

We are grateful in advance for your attention to the concerns expressed in this letter and we welcome the opportunity to discuss these with you. In case there is any additional information that we can provide, please contact EFAMA at info@efama.org or +32 (0) 2513 3969.

Kind regards,

Peter De Proft
Director General
EFAMA
22 April 2016

BY EMAIL: taxtreaties@oecd.org

TREATY ENTITLEMENT OF NON –CIV FUNDS

The Financial Services Council welcomes the opportunity to make a submission in response to the BEPS consultation document on the treaty entitlement of Non – CIV funds that was released for public discussion on 24 March 2016.

The Financial Services Council (FSC) represents Australia’s retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, trustee companies and public trustees. The FSC has over 125 members who are responsible for investing more than $2.5 trillion on behalf of 11 million Australians. The pool of funds under management is larger than Australia’s GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world.

Please contact me with any questions in relation to this submission on (02) 9299 3022.

Yours sincerely,

Andrew Bragg
Director of Policy
In responding to this discussion paper it is acknowledged that there will be some overlap with issues contained within the OECD’s paper – The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles- of 23 April 2010. However, as that paper does not specify “what is a CIV”, we are concerned that there are some Australian investment entities not covered, particularly unit trusts. The current discussion paper seems to implicitly recognise this in its discussion questions and this has influenced the entities envisaged in this response.

**Australian funds management industry**

Australia’s long-term retirement income challenges mean that long-term investment options are needed, with stable and transparent tax outcomes. Existing international investment structures have been designed to allow for co-investment with institutions from diverse countries, pooling investment capital and diversifying investment risk, and allowing for efficient repatriation of profits and capital.

Jurisdictions such as Luxembourg, Ireland or the Cayman Islands are often used by Australian fund investors, as they have existing fund vehicles, and legal and financial regimes that support these needs by providing flow-through tax treatment.

**Superannuation funds**

We refer to the submission from the Association of Superannuation Funds of Australia (“ASFA”) dated 1 April 2016 in response to the OECD’s Public Discussion Draft entitled “Treaty Residence of Pension Funds” (dated 29 February 2016 with comments released by the OECD on 1 April 2016), which contains a description of the Australian superannuation fund sector.

A superannuation fund must be set up in accordance with the Superannuation Industry (Supervision) Act 1993. The taxable income of a complying superannuation fund will be taxed at 15%, with certain capital gains taxed at 10%. However, income earned from assets held to provide for “super income stream benefits” (namely pensions) can be exempt from tax in certain circumstances.

Large superannuation funds often offer different asset classes for investors to choose from, which requires numerous assets to be held. The assets of a superannuation fund are likely pooled through a life insurance company, a pooled superannuation trust or a unit trust.

The units in a pooled superannuation trusts can only be held by Australian superannuation funds and life insurance companies in respect of policy holders which are Australian superannuation funds. Pooled superannuation trusts are taxed in the same manner as superannuation funds.

**Life insurance companies**

Life insurance was traditionally designed for individuals, and provided a lump sum pay-out on death or an income stream in the case of sickness or disability. However, life insurance is now commonly used as an investment product and by superannuation funds to pool investments.

In Australia, life insurance companies are those companies that carry on life insurance business and are registered under the Life Insurance Act 1995 to write life insurance policies.

Life insurance companies determine the amount of the premium payable by the insured, and invests its assets (premiums less expenses) in a range of assets, including offshore investments. These accumulated assets are then used to pay out risk policies when certain events occur.

The taxation of a life insurance company basically splits the taxable income into three components:
• The accumulation phase superannuation business of a life insurance company is taxed at
15% (similar to a superannuation fund), and only applies to superannuation policies that relate to
members of a superannuation fund where the members are still in the accumulation phase;

• The pension / annuity phase business of a life insurance company is exempt from tax (similar
to the “super income stream benefit” exemption discussed above); and

• The remainder of the life insurance company’s business (including fees from the
superannuation related business) are taxed at the general corporate tax rate of 30%.

Other trusts

Another common investment vehicle in Australia is a unit trust or managed investment scheme.
Managed investment schemes are regulated by the Corporations Act 2001.

The basic concept of a trust relationship is that the beneficiary is the beneficial owner of property
which is the subject of the trust, which is legally owned by the trustee. There is no restriction in
relation to the ownership of unit trusts, and these may include other Australian trusts, Australian
superannuation funds and non-resident investors.

Generally, a trust will be taxed as a flow-through vehicle. That is, the beneficiary or unitholder will
be taxed on their share of the taxable income of the trust, where they are presently entitled to that
income. The beneficiary will pay tax on their share of the taxable income of the trust at their
relevant tax rate.

Typical fund structures

Australian superannuation funds, managed investment trusts and life insurance companies regularly
invest through non-CIV entities. This pooling of investments allows for economies of scale to allow
for investments in larger assets, access to other fund managements or advisors and diversification of
risk.

Often a regional platform is set up by an Australian fund (or funds), for example a Luxembourg entity
for all European investments. This would allow for the following benefits:

• Pooling of various investors and capital (i.e. various Australian funds can take a stake in the
same underlying asset); and

• Personnel with greater knowledge of the asset are likely to be closer to the asset, in terms of
knowledge and time zones.

A variety of factors would contribute to the determination of the location of the regional platform
entity, of which tax certainty would be one factor.

1. What would be the threshold for determining that a fund is “widely held” for the purpose of
such a proposal?

While we welcome the suggestion that the limitation on benefits (“LOB”) clause should be widened
to deal with flow-through vehicles, the suggestions in paragraph 7 may be too limiting. This is on the
basis that many of these suggestions deal with provisions in specific jurisdictions (specifically the
European Union and Ireland). This may mean that vehicles outside the European Union may have
greater difficulty in determining whether the exemption could apply to them.
We agree with the suggestion of a provision which allowed a flow-through vehicle to access the LOB provisions where they have a sufficiently high level of investors (80% is mentioned in paragraph 15) would be entitled to the same or better treaty benefits.

However, we would argue that this should be broadened to introduce the concept of a “deemed widely held” vehicle. If the intention is to allow vehicles held by certain investors to have access to the LOB provisions, then a vehicle that is held by another vehicle held by certain investors should also have the same access to the LOB provisions.

For example, where an Australian superannuation fund or Australian life insurance company owns 80% of the units in an Australian unit trust, which owns 100% of an offshore asset, then the superannuation fund or life insurance company should be a widely held entity and the unit trust should be a “deemed widely held” entity. This would require a certain level of tracing of investors by each of the entities, but would fit with the intention that if the ultimate investor could access treaty benefits, then the holding vehicle should be able to access those benefits.

Further, paragraph 8 discusses the suggestion from certain commentators that a safeguard be added such that a vehicle should be denied treaty benefits where 10% (for example) or more of the fund was owned by a single beneficiary. However, we note that this measure should not apply where that 10% owner is a “deemed widely held” entity, is itself able to access treaty benefits or a flow-through vehicle where more than 80% of its owners are able to access treaty benefits (e.g. an Australian superannuation fund or life insurance company). This should be in line with the policy intent that a vehicle with a majority of its investors (at all levels of investment) should be entitled to access treaty benefits.

2. What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

A regulatory framework requiring participation in the Common Reporting Standard [“CRS”], FATCA or any successor regime is an acceptable requirement. Additionally it is suggested that the entity be registered with the national securities regulator for its home jurisdiction [or another international regulator in the case of the EU]. If a non-CIV is widely held it may not be necessary to specify a requirement for registration under a local regulator.

3. Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

Concern about treaty shopping by third country investors in the non-CIV is best addressed by first considering what sort of non-CIV would be attractive for such a scheme. It is suggested that a Non-CIV that is widely held and subject to regulation is unlikely to be used as a treaty shopping entity, particularly if the entity is resident in an OECD country.
4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

Fundamentally there are three possible scenarios. A. the non CIV is a roll up vehicle that does not distribute but pays tax in its own right. This scenario should not pose a problem. B. the non CIV is not taxable as its income is distributed [deemed or actual] to its investors. Such investors would be taxable in their own right hence there is no mischief. C. the non – CIV vehicle is a roll up vehicle which is not taxable in its own right or is only nominally taxed. This last scenario does give rise to deferral issues. Hence the use of treaty benefits by non – CIVs should be limited to exclude non Taxable CIVS that are roll up vehicles.

[Pension funds could be construed to be non-taxable CIVS that are roll up vehicles. However, their special status has been recognised in most treaties with specific rules such that for the purposes of the proposed LOB rules pension Funds can be a qualified person under paragraph 2(d)]

Additionally, jurisdictions with a controlled foreign company (“CFC”) or similar attribution regime means there should not be significant deferral of income. As the OECD will be aware, Australia has robust CFC rules that operate to ensure that passive income is attributed to Australian controlled foreign entities.

5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

As suggested in the response to question 3 this concern is somewhat theoretical. However, it is suggested that restricting the exception to non – CIVs in OECD countries may alleviate these concerns.

6. One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

True intermediaries are usually fiscally transparent vehicles that funnel equity investment into the non-CIV. Taxable intermediaries are usually special cases such as life insurance companies and some retirement funds. These can be considered as the equivalent to the ultimate investor.

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?
A practical difficulty encountered by fiscally transparent vehicles is that the source jurisdiction may insist upon beneficial interest details at the time of each interest or dividend payment from each investment. This may result in excess of 100 test dates across tens of thousands of investors, which is commercially not practical to comply with. It is suggested that the non-CIV should be able to adopt an average beneficial interest statement based upon the respective values at the beginning of the previous financial year and the end of the previous financial year. Such an average would be used for all income derived in the relevant financial year.

Given the practical difficulties, we recommend that the treaty address this matter (rather than being a matter for the laws of each jurisdiction). Consistent with the concept outlined in paragraph 15 of the OECD’s public discussion draft, it is suggested that non-CIV funds be entitled to treaty benefits where they have a sufficiently high level of investors who would be entitled to treaty benefits. As already mentioned, we would propose this threshold should apply to various levels of holdings.

8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

Institutional investors include:

- Life insurance companies
- Pension funds and retirement funds
- Wholesale CIVs
- General Insurance companies
- Recognised charities.

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

The definition in para 6.8 is – “funds that are widely led, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established”. The challenge represented is that the meaning of “widely held” does not allow for investment by intermediate vehicles. Further, what amounts to a “fund” is unclear which causes difficulties for financially transparent vehicles such as unit trusts. A more specific definition of CIV is required before it is possible to delineate acceptable and non-acceptable non-CIVs.

10. Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

Such rules could address the use of nominees and other types of investor who have no beneficial interest but confer residency in a jurisdiction that provides attractive benefits.

11. What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?
A bona fide investment objective is an investment that is predominantly passive and is part of a portfolio of investments.

12. How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

Funds may be designed for differing investment objectives and typically will be offered to certain types of investor’s e.g. individual or large institutional wholesale customers. Not all investors will be able to invest in all funds, however that should not mean those funds are not being “marketed to a diverse investor base”. We suggest such a determination be based on the fund being openly offered to investors for investment, without a restriction being placed on whether that fund has specific eligibility criteria e.g. minimum investment amount.

Paragraph 17 makes the suggestion that the derivate benefits rules could only apply to funds that are wholly owned by institutional investors. For clarity, we recommend that such a requirement not be needed as there should be no difference in the eligibility of treaty benefits whether you are an institutional or individual investor. As long as there is a sufficiently high level of investors in the fund who would be entitled to the same or better treaty benefits, the derivate benefits rule should treat them equally. KYC/AML requirements are imposed on all investors, not just institutional.

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

As indicated in the answer to question 7 ownership interests do change hands not infrequently particularly for widely held entities. Hence it is practically necessary to develop an acceptable method of establishing the appropriate qualifying percentage for treaty relief.

14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

Whilst many non-CIVS cannot assert the residency status of 100% of their beneficial owners it is usually possible to assert the residency status of a lesser percentage and that percentage should be capable of attracting available treaty benefits even if the remainder cannot. If necessary such percentages could be vetted by external auditors or the revenue authority of the home jurisdiction.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

All widely held regulated funds resident in jurisdictions participating in the CRS regime are in process of establishing residency certification and KYC procedures. Hence for individuals typically and address, country of tax residence and date of birth are normally held.

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payers that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining
information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

There are very often commercial reasons for an investment to be made through multiple subsidiary entities. As examples, to provide greater flexibility (and therefore price) in a potential sale in the future, ring-fencing assets for the purposes of financing, to facilitate co-investment/partnering and to undertake specific investment activities.

The consideration of the purpose of a structure should not be limited to just the “top” entity in the structure within a jurisdiction. Rather, the entire holding structure should be considered together when considering whether the principal purpose of an arrangement or transaction would be in accordance with the object and purpose of the relevant treaty provisions. Consideration of an overall structure, rather than a piecemeal approach to each entity, is not inconsistent with the intention of these provisions. That is, an organisational structure utilising more than one entity in a jurisdiction neither adds to nor detracts from the economic and commercial nexus to that jurisdiction.

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

If a fund was only able to claim an 80% benefit that would mean that “non treaty shopping investors” were being required to partially share their treaty benefits with the treaty shopping investors. If the treaty shopping investors were substantial and deliberate then the managers/trustees of the non-CIV would be in breach of their fiduciary obligations to all investors. Additionally the non-treaty shopping investors would quickly realise they were being exploited and would desert the non-CIV.

19. One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

The 50% base erosion requirement would mean that less than 50% of the taxable income of the fund is distributed to non-equivalent beneficiaries. Provided the derivate benefits test requires a sufficiently high level of investors (as proposed by the paper at 80%) to be equivalent beneficiaries it would be unlikely that the base erosion percentage would need to be lifted. The 80% test should contain the treaty benefits to the eligible claimants.

20. According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than
the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

See our answer to question 4.

21. As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

Firstly it should be noted that many retirement funds are tax exempt but are acceptable investors for treaty purposes. Hence retirement funds investing through non-CIVs do not give rise to a mischief. In the case of multiple layers in an investment structure it is challenging to be prescriptive. What is needed is for the managers of the Non-CIV to receive adequate assurance as to ultimate beneficial ownership. Such assurances may not cover 100% of the investor base and hence not all income will attract the benefit of treaty concessions.

22. The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016 (see https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-206.pdf, paragraph 4 of Article 22 “Limitation on Benefits”). Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

- More onerous requirement of 95% ownership rather than the OECD 75% (simplified version) ownership by equivalent beneficiaries.
- Requirement of seven or fewer will not work for widely held funds
- Certain funds may be additionally subject to the ‘tested group’ limitation. This would largely depend on the definition of what should be contained with a group for tax purposes (exemption if any).

23. Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

24. Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
- What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?
25. Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

26. Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

27. Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released in February 2016 (see question 22 above). If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

28. Please describe briefly any approach not already mentioned in this consultation document or in previous comments that could address concerns related to the way in which the new treaty provisions included in the Report on Action 6 may affect the treaty entitlement of non-CIV funds without creating opportunities for treaty-shopping or tax deferral.

Example

TNon-CIV fund, treated as fiscally transparent under the domestic law of a third State, State T, is established to invest in a portfolio of investments internationally. The fund is marketed to pension schemes, life insurance companies and non-CIVs and CIVs of institutional investors on the basis of the investment mandate of the fund. The investment strategy of the fund is not driven by the tax position of the investors, rather the investment strategy is driven by short-term or long-term investment return.

RCo, a company resident in State R, is an intermediate vehicle of TNon-CIV. RCo is established exclusively to acquire the investments of TNon-CIV in jurisdictions consistent with the investment mandate of the fund. The decision to establish RCo in State R takes into account the existence of tax benefits provided under State R’s extensive tax convention network. However, this decision is mainly driven by business friendly environment, economic, legal and political stability, proximity to markets and underlying investments in mandated jurisdictions, legal flexibility and simplicity to repatriate proceeds from sales of the portfolio, appropriately qualified personnel and time zone efficiencies.

In making its decision to establish RCo in State R, the fund manager of TNon-CIV did consider the existence of benefits under the tax conventions between State R and the jurisdictions in which the target investments are made, but this alone would not be sufficient to trigger the application of paragraph 7. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, if RCo’s investments are made for commercial purposes consistent with the investment mandate of the fund, it should receive treaty benefits. Unless RCo’s investments are part of an arrangement, or relates to another
transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the tax treaties between State R and the jurisdictions in which the target investments are made.

RCo’s invests in the shares of SCo, resident in State S, and the making of the investment has had regard to the existence of benefits under the tax conventions between State R and State S, but this alone would not be sufficient to trigger the application of paragraph 7. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, if RCo’s investment is made for commercial purposes consistent with the investment mandate of the fund, RCo should receive treaty benefits. Unless RCo’s investment is part of an arrangement, or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the tax treaty between State R and State S.

The establishment of a series of separate entities in State R to function as a regional platform to make the portfolio investments and which facilitate international pension schemes, sovereign wealth funds and other institutional investors such as life companies to invest via CIVs or Non-CIVs into one or more of the State R entities is a factor that alone would not be sufficient to change this conclusion.
Foreword from Guernsey’s Government, the States of Guernsey

Guernsey is a British Crown Dependency. It is not part of the United Kingdom, but the UK has ultimate responsibility for its international relations and defence. Guernsey enjoys a high degree of autonomy, including its own fiscal and judicial systems, and receives no financial subsidy from the UK or the European Union. By virtue of Protocol 3 of the UK’s Accession Treaty, Guernsey is part of the Customs Union and within the Single Market for the purposes of trade in goods, but not services and as such are treated as “third countries” in financial services regulation. Guernsey is part of the sterling zone and by virtue of equivalence under the EU’s Wire Transfer Regulation are part of the UK’s payment and clearing system.

The Organisation for Economic Co-operation and Development (OECD) Convention was extended to Guernsey in 1990 and therefore it is part of the UK for the purposes of its membership of the OECD. OECD decisions and recommendations apply to Guernsey to the same extent as they do to the UK unless the contrary is specifically stated in a particular case.

Guernsey’s regulator, the Guernsey Financial Services Commission (GFSC), is committed to ensuring its regulatory framework and practice meet international standards. It is an active participant in discussions of international standards through its membership of, or association with, the following international organisations:

- The International Organisation of Securities Commissions (IOSCO) – as a member and participating in standing committees C4, C5, C8 and the Assessment Committee and a signatory to the Multilateral Memorandum of Understanding;
- The International Association of Insurance Supervisors (IAIS) and the Offshore Group of Insurance Supervisors (OGIS) - as a member and signatory to the Multilateral Memorandum of Understanding;
- The Group of International Finance Centre Supervisors (GIFCS);
- The (OECD) – as part of the United Kingdom’s membership;
- The Council of Europe’s Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL);
- Through its membership of the Group of International Finance Centre Supervisors, it works with the Basel Committee on Banking Supervision (BIS) and the Financial Action Task Force (FATF) on money laundering;
- Guernsey has numerous bilateral regulatory co-operative agreements in place; and, through ESMA, Memoranda of Understanding under the Alternative Investment Fund Managers Directive (AIFMD) with 27 members of the European Economic Area.
Introduction

The Guernsey International Business Association (GIBA) is responsible for representing Guernsey’s financial services industry internationally. A key component of Guernsey’s finance industry is its investment funds sector. A report commissioned for the States of Guernsey in January 2015 highlighted that the Guernsey investment funds sector acts as a facilitator for some £150 billion of investment into global markets from global investors. Also noted within this report was that global investors are comfortable using Guernsey investment vehicles due to Guernsey being a well-respected and transparent jurisdiction with an established regulatory track record.

Guernsey has a strong and varied investment funds sector, particularly in the alternatives sector that spans private equity, infrastructure, debt and listed vehicles notably on the London Stock Exchange. The majority of Guernsey-based investment funds take the form of closed-ended corporate vehicles, although transparent partnership vehicles are also widely used. Therefore, in the main, Guernsey investment fund vehicles will be non-CIVs for the purpose of this consultation.

Guernsey is fully committed to the OECD’s Common Reporting Standard (CRS) to exchange information with tax authorities across the globe. Moreover Guernsey is part of the group of “early adopters” meaning it will be within the first wave of exchange of information under CRS. Guernsey signed up to exchange information under Inter-Governmental Agreements with both the US and UK and the first exchange with the US has now taken place. This demonstrates that Guernsey’s Government is committed to meeting these international standards and moreover has invested in the appropriate technology to ensure the process is streamlined, reliable and secure. The role of the CRS and technological capability for the fund vehicles to be able to access complete and accurate data on the underlying investors is key.

Guernsey is fully supportive of and committed to the OECD’s approach to separately address the treaty entitlements of non-CIVs. We completely agree that an appropriate solution is required to address the broad range of investment arrangements that fall under the non-CIVs classification. Herein you will find our responses to the questions that have been raised in the consultation document, focusing on those where we feel most able to offer insight.

GIBA, representing Guernsey’s investment funds sector, will be available to provide further information that might be required with regard to the current regulatory and transparency regimes that currently exist in Guernsey. In addition, we will be on hand to provide further detailed commentary and input in relation to some of the areas raised in this paper.

Patrick Firth
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Executive Summary

Non-CIV funds are a vital conduit for the flow of investment capital globally. The purpose of a fund, whether it is a CIV or a non-CIV is to allow the investment of pooled capital utilising the expertise of an investment manager. GIBA is supportive of a solution that will be appropriate to ensure non-CIVs are not worse off than their CIV counterparts and more importantly that there is a level playing field for all non-CIVs. We would strongly urge that any changes or solutions do not result in jurisdiction arbitrage whereby investment structures located in certain jurisdictions would be able to access treaty entitlements whereas equivalent structures based elsewhere would not be able to do so. We believe anything that created this result would be entirely counter to the aims of Action 6 and indeed the wider BEPS Project.

Whilst the proposal for a Global Streamed Fund is still at outline stage, in our view it merits further consideration. In particular, it creates a regime which conceptually should address the OECD’s concerns about treaty shopping. As stated above, with the advances in global information exchange, it should be possible to create a framework which builds on tax reporting systems that are already in place.

In the interest of investor protection, we recommend that focus should be rightfully placed on high regulatory standards in the jurisdictions of the non-CIVs. Investment vehicles domiciled in jurisdictions without demonstrable regulatory supervision should not be eligible to become a GSF. The GSF appears to be the most equitable and holistic way to assess treaty entitlement, focussing on the eligibility of the underlying investor base, and not on the eligibility of the investment vehicle, thus avoiding the potential for inconsistencies in treaty eligibility between the fund vehicle and its investors.

GIBA, representing Guernsey’s investment funds sector, will be available to provide further information that might be required with regard to the current regulatory and transparency regimes that currently exist in Guernsey. We are aware that our comments have not addressed a number of practicalities that will be inherent with introducing any new regime and therefore we will also be happy to provide further detailed commentary and input in this regard.

SUGGESTION THAT TREATY BENEFITS BE GRANTED TO REGULATED AND/OR WIDELY-HELD NON-CIV FUNDS [Questions 1-6]

To the first point on regulation, it will be vital that treaty benefits should only be available to investment vehicles that are subject to appropriate regulatory supervision. The location of the fund vehicle is important; it should be located in a well-regulated jurisdiction that has appropriate investor protection law. We would recommend that adherence to a single overarching framework that lists acceptable and appropriate regulatory environments should be used. For example, the IOSCO list might be appropriate.

Guernsey provides a well-regulated regulatory environment for investment funds that is highly regarded internationally. The Guernsey Financial Services Commission (GFSC) prescribes a regulatory framework that adheres and, in many cases, goes beyond the current international standard. Indeed, the most recent evaluation by Moneyval stated that the regulatory environment in Guernsey is of a high standard, with no instances of “non-compliance” with the internationally accepted standards, which is a testament to the quality and diligence of our local regulator.
With regard to the AIFMD, although it is outside the EU Guernsey has put in place a domestic regulatory regime that can facilitate full AIFMD compliance for those managers that would require this for their particular investor base. With regard to third country passporting, Guernsey is one of the first jurisdictions that received a recommendation from the European Securities & Markets Authority (ESMA) that it should be put forward for approval as a third country jurisdiction, which is a testament to the robust regulatory environment that exists in Guernsey.

In any case, we are in favour of the idea that all jurisdictions would be required to adhere to one overarching standard, which should eliminate jurisdiction arbitrage with regard to regulation. In turn this should foster the notion that investment vehicles should instead be driven by commercial principles rather than anomalies that exist between jurisdictions with regard to access to treaty entitlements.

To the second point on the notion of what constitutes “widely-held”, we believe that there should be a restriction to investment arrangements that are genuinely widely held and represent genuine pooled arrangements of capital. Guernsey itself has a regulatory requirement for diversity of ownership. It may be possible to introduce a prescribed threshold and there are examples within UK tax legislation that could be appropriate in this regard. Any such threshold should not disadvantage non-CIVs from their CIV counterparts.

In any case, we would propose that it would sit with the relevant regulator to be the gatekeeper for the widely-held condition. We also believe this is a sensible approach due to the fact the costs associated with being compliant with a regulatory framework, such as the one in Guernsey, should work to ensure that only genuine arrangements that are diversely held would need to be subject to regulatory rules in the first place.

The concerns regarding tax deferral are addressed later in this paper at Questions 20-22.

**NON-CIV FUNDS SET UP AS TRANSPARENT ENTITIES [Question 7]**

Currently there are instances where there are difficulties for transparent entities to always be in a position to capture the relevant information that is required for the investor base, including tax status and residence. However with the advent of the CRS together with greater technological sophistication in this area, this difficulty and concern with capturing the requisite information on the investor base will fall away. Therefore, we do not believe that the tax transparency classification of a vehicle should be a variable in itself to determine treaty entitlement. Investment vehicles, be they transparent or opaque should be obliged to fulfil certain responsibilities with regard to capturing information on their investor base, in order to avail of treaty entitlement, and the CRS and technology will facilitate this. This will be discussed in greater detail later in this paper, where the issue of tax deferral will also be addressed.

**SUGGESTION THAT THE LOB INCLUDE A DERIVATIVE BENEFIT RULE APPLICABLE TO CERTAIN NON-CIV FUNDS [Questions 8-19]**

Non-CIVs span a very wide range of scenarios with various investment strategies and investor bases. In particular, investor bases can include a broad sweep of possible investor types including pension funds, national government funds, insurance companies, banks, college endowments and other charitable organisations and many investments might in turn be held through either nominee accounts or other structures or arrangements. We would suggest that any solution to accommodate non-CIVs should do so in a holistic way, which would accommodate the disparate nature of non-CIV funds.
CIVs. Key to dealing with this point is that responsibility should sit with the investment fund vehicle itself to ensure it has the capability to identify the nature and residence of investors. Although this will vary depending on the fund type, many non-CIVs such as private equity and closed-ended funds will not have frequent changes in the investor base.

In any case investment funds that are based in CRS compliant jurisdictions will be in a position to achieve this. Moreover they will be able to do it in a much more complete and accurate way, removing the need for statements in relation to investors such as “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative fund”. The arbitrary 80:20 threshold for treaty entitlement would no longer be required, given the precision that the CRS will be able to provide.

Ultimately therefore, the responsibility that would sit with the investment vehicle is that it would be required to provide the requisite information on the status and residence of its investor base to the tax authority in that jurisdiction. Further consideration would need to be given to the matter of privacy of investor information. Initial views would be that the exchange of investor information between tax authorities would need to be limited to exchanges pursuant to a Double Tax Treaty or Tax Information Exchange Agreement whereby the requesting tax authority undertakes to protect the privacy of the information requested.

Therefore, in Guernsey we believe it is time to utilise the combination of global exchange of information with technological sophistication to remove the need to rely on imprecise standards that needed to be in place in the past, and this will allay many of the concerns that hinge around ensuring that certain investment vehicles do not avail of treaty entitlements that are over and above what the underlying investor base would be entitled to.

**QUESTIONS RELATED TO THE PREVENTION OF DEFERRAL [Questions 20-22]**

Typically, investors are taxable on receipt of distributions from investment funds. In many cases, non-CIV funds will distribute proceeds to investors on a regular basis and sometimes this is a requirement, for example, for private equity funds. Where income is not distributed it may be reinvested and in this case the income may not be taxable. The purpose would typically be to reinvest and grow the value of the investments. The purpose is not to defer tax.

However, in order to address the concern around deferral of tax by investors, it would be possible to introduce a requirement for the non-CIV to distribute fully income and realised gains at specified intervals. Distributions could be actual or deemed depending on the nature of the particular non-CIV. There are already a number of regimes that have similar rules in place to ensure investors resident in their jurisdictions are taxed either on actual distributions annually or on deemed distributions, often referred to as “dry income”. Most notable are the US, UK and German “reporting” regimes, which include such anti-deferral provisions.

Therefore, investment vehicles that have investors in the UK, US and Germany are already familiar with such rules that prevent the roll up of income in investment vehicles free of tax. Moreover the investors are familiar with and are not adverse to these regimes.

Therefore there are existing precedents for an anti-deferral regime which are familiar to the investment management industry, albeit not yet on a global scale. Again the CRS and use of technology will facilitate the capability of investment vehicles to distribute (actual or deemed) at regular intervals. Whilst there will be some further practicalities that will need to be considered,
particularly around deeming provisions, we see no reason why an anti-deferral regime could not be applied on a global scale and become the norm for all investment arrangements.

With regard to the use of intermediate companies located in different jurisdictions within an overall investment structure, the purpose of intermediate companies is often to avoid undue additional tax arising which will diminish the return of the investor and therefore the entity level tax is typically minimal. In our view any tax-avoidance risk would be dealt with by other areas of the BEPS Project, notably in relation to the Actions that are concerned with treaty shopping, interest deductibility and hybrids. That said, we do believe that where a non-CIV fund is eligible for treaty benefits because it has met the agreed criteria, then that treatment should automatically flow down to intermediate companies located in other jurisdictions.

**SUGGESTION OF A “GLOBAL STREAMED FUND” REGIME [Question 24]**

The question comes to whether the eligibility for the treaty entitlement should sit with the investment vehicle itself, or the actual underlying investors.

In answer to this important question, we believe that there should be a look-through provision with reference to the underlying investors along the lines of the Global Streamed Fund (GSF) for closed-ended funds.

Although this proposed regime would be a significant shift to the global investment funds market, this in itself is not a sufficient reason to not further explore the suggestion. It is worth referring back to Action 6, which is concerned with instances where treaty benefits are claimed in situations where they were not intended to be granted, thereby depriving countries of tax revenues. Therefore, we believe that the GSF is in line with the intention and aims of Action 6, as the underlying investors would only be entitled to treaty access in the same way as if they had invested directly rather than via an investment fund vehicle. Furthermore, there is an argument to support the view that this is a more equitable way of determining eligibility for treaty exemptions, as it removes the ability for certain investment vehicles to obtain treaty exemptions for investors over and above what they would otherwise have been entitled to. Therefore, the GSF has the effect of limiting the benefits with regard to where the underlying investors are based.

CRS will be a facilitator for achieving this. As a result of the data that will be to hand from compliance with CRS, the investment fund vehicle will be able to provide a list of those investors that are entitled to treaty benefits, and those that are not. For the latter group, then the fund vehicle itself would be required to withhold the appropriate amount of tax and pass it to the tax authority.

**Answering the bullet points to Question 24:**

- As discussed above, the requirement to distribute, whether actual or deemed at regular intervals should not create any difficulties for the GSF.
- Non-CIVs that are located in well-regulated jurisdictions that comply with the CRS will be well positioned to determine who their investors are.
- There should be no significant legal or practical difficulties associated with the non-CIV acting as the collecting agent in the relevant instances and remitting any tax withheld to its tax authority. Investors entering the GSF would be aware of this at the outset. Domestic rules would have to be lined up to ensure the tax authorities are able to remit the tax withheld onwards to the appropriate territory of the investor or where the relevant income

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and gains are sourced. The basic mechanics for exchange of information on investors will be in place to facilitate this under the CRS.

- Mirroring, for example, the UK regime for UK resident investors in offshore funds, the GSF regime would be an elective one, whereby the investment vehicle would require approval upfront to enter, with its tax authority. Therefore, only non-CIVs that are willing and able to comply with the requirements of the GSF regime would be approved to be a GSF. Once approved, the GSF would have annual reporting compliance obligations to demonstrate to its tax authority that it was in fact in compliance as required. We believe it would also be possible to introduce certain penalty measures for failure to comply with the GSF requirements. Such measures could be either monetary penalties but should vary depending on the magnitude of the failure to comply with the rules, and the ultimate penalty would be removal from the GSF regime, which would result in withdrawal of treaty entitlement for the underlying investors.
Dear Sir or Madam

Public Consultation on Treaty Entitlement of Non-CIV Funds

The Irish Debt Securities Association (IDSA) welcomes the opportunity to respond to the public discussion draft on the treaty entitlement of non-CIV funds dated 24 March 2016 (the Discussion Draft”).

In our submissions to the OECD’s two previous consultation papers on Action 6 (Prevent Treaty Abuse), we outlined and highlighted the role of securitisation as an important alternative financing channel to bank funding and its role in filling the “bank funding gap”. We also outlined the importance of treaty access to the securitisations sector given the international nature of the industry.

Securitisations represent a segment of the non CIVs sector that are largely subject to a different regulatory regime than CIV funds and are subject to “risk retention” rules. The fact that the sector is subject to a different regulatory regime than CIVs does not mean that they should be denied treaty access and from that perspective we would make the following general observations on the Discussion Draft:

- The most surprising omission to date has been a definition of non-CIV funds. The description suggests a supply of capital provided by unconnected investors. However such a test cannot be simply applied at the level of the fund claiming treaty benefits. There are many situations where a fund is owned by a small number of investors or even a single owner, but where indirectly a large number of investors are involved (e.g. in fund of fund, feeder fund structures etc). Indirect ownership would therefore have to be taken into account in any definition of a non-CIV fund.

- In many instances there should be no need to differentiate non-CIV funds from CIVs, and where relevant the recommendations of the 2010 Report should be equally applied to non-CIVs. This would entitle non CIVs to Treaty benefits subject to satisfying specific applicable requirements.
• We are surprised at the concern being expressed on treaty access where deferral of tax is involved. In our view, once earnings are being reinvested within the fund and are not being distributed to the investor there should be no denial of treaty benefits. Specific action to counter deferment would also be discriminating against non CIVs relative to many other taxpayers, including CIVs.

• The Discussion Draft appears to suggest, that a derivative benefits rule might only be applied to institutional investors. In our view this approach could not be justified. Derivative benefits should be applied to all investors, in circumstances where a minimum threshold (80% has been suggested though a lower % could be justified) equivalent beneficiary test is satisfied, and we see no reason why any restrictions or carve outs should be imposed.

• In relation to the actively traded requirement mentioned in the Discussion Draft, Securitisation Notes that are listed and widely held may not be traded on an exchange while there can be circumstances involving clearing systems where investors in a fund are unknown. It has to be borne in mind here though that securitisation companies have investor tax reporting obligations under FATCA and CRS. In the “unknown cases” payments are generally made to custodians or financial institutions which themselves have investor reporting obligations.

• The proposals made in relation to a ‘global streamed fund’ regime are interesting but impractical at a number of levels, particularly in the context of requiring domestic tax law changes to implement.

• In relation to the PPT rule some additional examples were suggested. A typical securitisation example would be as follows:

  BankCo is a bank established in State Q. BankCo wishes to raise new capital and de-risk its balance sheet and has identified a pool of loans which it has originated and that can be sold to raise the capital it requires. BankCo establishes RCo, a securitisation company resident in State R. RCo has only nominal share capital which is held by an independent share trustee on trust for charitable purposes in order to ensure RCo, as the securitisation company, is “bankruptcy remote” which is an appropriate commercial characteristic for the success of the securitisation transaction. RCo raises debt finance by issuing bonds to investors in the capital markets. The bonds are widely held by investors and are listed on a recognised stock exchange. In accordance with EU requirements BankCo is required to retain a 5% interest in RCo that is subordinated to all other debt holders. RCo uses the proceeds of the bond issuance to acquire the portfolio of loans from BankCo. The loans are owed by debtors located in a number of jurisdictions. Specifically a portion of RCo’s portfolio is held in receivables of SMEs resident in State S, in respect of which RCo receives regular interest payments. Under the tax convention between State R and State S, the withholding tax rate on interest is reduced from 30% to 10%.

BankCo’s decision to establish RCo in State R is driven by State R’s securitisation legislation, established credentials as a location for establishing securitisation companies, skilled and knowledgeable labour force and professional services market, membership of a regional grouping and the comprehensive double taxation treaty network of State R, including its tax treaty with State S, which provides a reduced rate of withholding tax on interest. Furthermore, it
is established that at least 80% of the investors in RCo are institutional and other professional investors located in jurisdictions with similar or lower rates of withholding tax on interest than 10% under their treaties with State S. Investors’ decisions to invest in RCo are not driven by any particular investment made by RCo and RCo’s investment strategy is not driven by the tax position of investors. RCo is taxed in State R on income earned and is entitled to a full deduction for interest payments made to investors.

In this example, merely reviewing the effects of State R’s tax treaty with State S on interest payments by the SME debtors in State S to RCo, or the fact that State R has a comprehensive double tax treaty network, would not enable a conclusion to be drawn about the purpose for the establishment of RCo by BankCo. The intent of tax treaties is to provide benefits to encourage cross-border investment and RCo was established as a result of a genuine commercial decision made and implemented by BankCo and provided RCo’s business is properly conducted in State R through, for example, the making of decisions necessary for the conduct of its business by skilled personnel with the knowledge and experience appropriate to make such decisions and assume real risks, it would not be reasonable to deny the benefit of the State R / State S tax convention to RCo.

• We also propose that all SPVs that fall within risk retention rules (or similar regimes) in any OECD member state be presumed to qualify for treaty benefits in that member state. To do otherwise would undermine the policy of such rules (and the EU Capital Markets Union).

• IDSA notes the proposed changes in the ‘special tax regime’ proposal but still has largely the same concerns as expressed in our June 2015 submission to the OECD, which is attached for your information. The ‘special tax regime’ proposal is a wholly subjective concept. There are no objective bench marks as to what a tax regime has to be compared with. In the absence of such objective criteria, taxpayers and tax authorities are likely to attempt to evaluate qualitative differences between their local and foreign tax regimes to decide if a foreign tax regime is ‘special’. Taxpayers and tax authorities will inevitably adopt conflicting positions with respect to the same foreign tax regime. A taxpayer or tax authority (as the case may be) may consider a particular foreign tax regime to be ‘special’, though another taxpayer or tax authority may not. This will result in an inconsistent approach amongst taxpayers (including taxpayers in the same OECD jurisdiction) and an inconsistent approach amongst different OECD tax authorities, in each case with respect to the same taxpayer. Inevitably whether a regime is viewed as fitting within the definition of a special tax regime will become a matter for treaty negotiation at a bilateral level and will introduce inequalities predicated on strength of a negotiation position, timing of treaty discussions etc. Also EU law has to be taken into account here. The ECJ has already concluded (in Case C-318/10) that local tax rules that determine the tax treatment of a payment made in one EU Member State by reference to the characteristics of the tax system of another EU Member State are contrary to European law. In this regard, any proposal relating to special tax regimes could not be applied to tax treaties between EU Member States.

Yours faithfully,

GARY PALMER

The IDSA welcomes the opportunity to comment on the BEPS Revised Discussion Draft on Action 6: Prevent Treaty Abuse, issued on 22 May 2015 (the “Revised Action 6 Discussion Draft”).

In our previous response to the 21 November Discussion Draft “Follow-up Work on BEPS Action 6 (Prevent Treaty Abuse)”, dated January 9, 2015 [and attached, for reference, as an Appendix, to this letter], we outlined the importance of the role of the securitisation industry as an alternative to bank funding and its role in filling the “bank funding gap”. We also outlined the importance of treaty access to the securitisations industry and that treaty access in the area of securitisation had so far been overlooked in the Action 6 workstream.

We acknowledge that the Working Paper has heard these concerns through comments included in paragraph 22 of the Revised Action 6 Discussion Draft “…the Working Paper recognised the importance of [non-CIV] funds and the need to ensure treaty benefits be granted where appropriate. It also noted, however, that most suggestions included in the comments received did not sufficiently take account of treaty-shopping concerns.”

And paragraph 24 “The Working Party agreed that it should continue to explore solutions to issues related to the treaty entitlement of non-CIV funds that would address two general concerns that governments have about granting treaty benefits with respect to non-CIVs: that non-CIVs may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits and that investors may defer recognition of income on which treaty benefits have been granted. Possible options that the Working Party intends to further discuss at its June meeting include adding a specific provision on non-CIVs in the LOB rule and adding one or more examples on non-CIVs to the Commentary on the PPT rule.”

Recommend continuance of work on Action 6 and application to non-CIVS post September 2015 deadline

We note the comments of the Working Party in paragraph 24 of the Revised Action 6 Discussion Draft “…that work on [options to add a specific provision on non-CIVs in the LOB rule and adding one or more examples on non-CIVs to the Commentary on the PPT rule] and other options might continue after the September 2015 adoption of the final report on Action 6 but should in any event be completed before the December 2016 deadline for the negotiation of the multilateral instrument that will implement the conclusions of the work on Action 6.”

We would strongly advocate that this approach be followed. As outlined in our previous submission a securitisation company in any jurisdiction will likely fail the base erosion test contained with the proposed “detailed” LOB since it may not be in a position to identify who its bondholders are. Thus a securitisation company may ultimately never be in a position to demonstrate that it satisfies the LOB test other than through applying for discretionary relief under paragraph 5 of the proposed LOB. This may be the case even though its bondholders may be institutional investors in OECD member states.
Applying for discretionary relief under paragraph 5 is not a viable option. It would be time-consuming, costly and likely to lead to inconsistent results between different jurisdictions; in addition to the harm the uncertainty would cause the securitisation industry as a whole.

Therefore, the IDSA considers that the only available solution for the securitisation industry, under the current Treaty-Abuse proposals, is to satisfy the “standalone” PPT rule. Securitisations are generally effected for bona fide commercial purposes and not for the purposes of tax avoidance or treaty abuse. For this reason, IDSA considers that securitisation vehicles should qualify for treaty benefits under any PPT rules. It is therefore critical for the securitisation industry, that the PPT rule and related commentary and examples are “fit for purpose” and are clear on how the PPT should operate in practice and apply to the securitisations industry. The Working Party has indirectly acknowledged this in paragraph 24 where it states its intention to discuss adding one or more examples on non-CIVs to the PPT rule. We have drafted an example specific to the securitisation industry for inclusion in the PPT commentary below.

Furthermore, while the inclusion of an LOB test is vehemently not the preferred approach of IDSA, IDSA considers that the only available solution under the LOB approach is to develop a separate category of “qualified person” to apply to “cross-border” securitisation companies/vehicles which will make it clear when a securitisation vehicle will be treated as satisfying the “detailed” LOB. Further work should also be undertaken to ensure that the Derivative Benefits provision in the “Simplified” LOB is appropriate for the securitisations industry (e.g. through consideration of testing dates, minimum ownership threshold, etc.)

In order to ensure such provisions are properly drafted and take account of the concerns of all parties further consultation and study (along the lines of the 2010 CIV Report) for each of the industries in the non-CIV area will be required. In particular, should the LOB route be adopted, the practical and logistical challenges of trying to identify the investors and bondholders in securitisation structures will have to be given further thought – CIVs are further along this road due to the TRACE project and the extension of such a system or the development of something similar to non-CIVs will require further thought and consultation. In this regard we recommend that the Working Paper continues to work on the application of this work stream to the non-CIVs/securitisation industry post September 2015.

1. Example for inclusion in commentary to PPT rule of application of PPT rule to securitisation vehicle

In response to the Working Party’s request under paragraph 24 of the Revised Action 6 Discussion Draft, the ISDA proposes that the example outlined below be included in the commentary to the PPT rule. The PPT rule is especially important to the Securitisation Industry given that a securitisation company will, under current practices never be in a position to demonstrate that it satisfies the LOB rule based on the current drafts of the “detailed” and “simplified” LOB rules. Thus given the importance of the PPT rule to the securitisation industry and the importance of access to a tax treaty network to the securitisation industry, the commentary on the interpretation of the PPT should acknowledge that it is legitimate to recognise that an important consideration in deciding to locate and establish a business in a jurisdiction is the existence of a good tax treaty network and the
benefits it affords. The commentary should make explicit, at a minimum through the provision of clear examples, that this can be especially the case for smaller economies (where some of the wider business related benefits available in larger economies are not present) and where there are strong fundamental commercial reasons supporting the underlying business transaction and parties have flexibility to determine where to locate the business.

“BankCo is a bank established in State Q. BankCo wishes to raise new capital and de-risk its balance sheet and has identified a pool of loans which it has originated and that can be sold to raise the capital it requires. BankCo establishes RCo, a securitisation company resident in State R. RCo has only nominal share capital which is held by an independent share trustee on trust for charitable purposes in order to ensure RCo, as the securitisation company, is “bankruptcy remote” which is an appropriate commercial characteristic for the success of the securitisation transaction. RCo raises debt finance by issuing bonds to investors in the capital markets. The bonds are widely held by investors and are listed on a recognised stock exchange. BankCo also retained an interest in RCo. RCo uses the proceeds of the bond issuance to acquire the portfolio of loans from BankCo. The loans are owed by debtors located in a number of jurisdictions. Specifically 15% of RCo’s portfolio is held in receivables of SMEs resident in State S, in respect of which RCo receives regular interest payments. Under the tax convention between State R and State S, the withholding tax rate on interest is reduced from 30% to 10%.

BankCo’s decision to establish RCo in State R is driven by State R’s securitisation legislation, established credentials as a location for establishing securitisation companies, skilled and knowledgeable labour force and professional services market, membership of a regional grouping and the comprehensive double taxation treaty network of State R, including its tax treaty with State S, which provides a reduced rate of withholding tax on interest. Furthermore, it is likely that a majority of investors in RCo are pension funds and other financial institutions located in OECD member states. Investors’ decisions to invest in RCo are not driven by any particular investment made by RCo and RCo’s investment strategy is not driven by the tax position of investors. RCo is taxed in State R on income earned and is entitled to a full deduction for interest payments made to investors.

In this example, merely reviewing the effects of State R’s tax treaty with State S on interest payments by the SME debtors in State S to RCo, or the fact that State R has a comprehensive double tax treaty network, would not enable a conclusion to be drawn about the purpose for the establishment of RCo by BankCo. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, in order to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment is made. RCo was established as a result of a genuine commercial decision made and implemented by BankCo and provided RCo’s business is properly conducted in State R through, for example, the making of decisions necessary for the conduct of its business by skilled personnel with the knowledge and experience appropriate to make such decisions and assume real risks, it would not be reasonable to deny the benefit of the State R / State S tax convention to RCo”
2. Sample approach for specific provision to deal with securitisation vehicles in “detailed” LOB

As noted above the LOB approach is not the preferred approach of IDSA for trying to manage treaty-abuse concerns for the securitisations industry. For the reasons outlined above, a securitisation company will generally not be in a position to establish whether it satisfies an LOB test. Further securitisations are generally effected for bona fide commercial purposes and not for the avoidance of tax avoidance or treaty abuse. Thus IDSA believes that securitisation companies should start from the premise that they are entitled to treaty benefits rather than having to prove that to be the case. However in the interest of addressing the Working Party’s concerns as noted in paragraph 22 and trying to come up with an LOB that might work for the securitisations industry we propose that a separate category of “qualified person” be included in the LOB clause to deal with securitisation companies.

The OECD papers recognise that there are parallels between the issues arising for CIVs from the proposed LOB rules and the issues affecting non-CIVs. For these reasons we believe that non-CIV securitisation companies should be afforded similar treatment as is currently being contemplated for CIVs – taking account of the Working Party’s comments in paragraphs 22 and 24 of the Revised Action 6 Discussion Draft that any modifications to the LOB for non-CIVs needs to take account of treaty shopping concerns. In this regard IDSA propose the inclusion of a specific paragraph, a new paragraph 2(g), to apply to “cross-border” securitisation vehicles which is largely based off the proposed subparagraph 2(e) for privately held companies but adjusted to take account of issues identified as arising for CIVs and would heavily rely on the drafted commentary proposed for CIVs with appropriate adjustments for the securitisation industry/ non-CIVs. As noted above, further thought and consultation with industry will be required between all parties in order to get any such provision right and also make it practically implementable from an industry perspective. As noted previously, currently there is no system whereby a securitisation company can identify who are its bondholders and thus could not currently demonstrate that it satisfied the proposed LOB test below.

Finally, IDSA would like to highlight that any LOB should not undermine the rights of freedom of establishment and free movement of capital between Member States of the European Union. These principles are enshrined in European law. IDSA considers that the LOB, as currently proposed, could potentially undermine these rights and be incompatible with European law. For example, under the proposed LOB, a securitisation vehicle established in a Member State of the European Union would be entitled to tax treaty access where its bondholders are all tax resident in that same Member State. However, that same securitisation vehicle would likely not be entitled to treaty access where it: (i) was established in a different Member State; or (ii) raised capital from bondholders that were tax resident in a different Member State. This approach has the effect of allowing / denying tax treaty access on a discriminatory basis by reference to which Member State the securitisation vehicle is established in and / or has raised its capital from. The IDSA considers such an LOB approach could potentially be contrary to the freedoms guaranteed by European law.

3. Sample approach for specific provision to deal with securitisation vehicles in “simplified” LOB

While we acknowledge the revised “Derivative Benefits” test included in the “simplified” LOB, IDSA is concerned that given the wide investor base in securitisation transaction, the 75% ownership
threshold would be difficult to substantiate in practice and a 50% threshold is more appropriate. Accordingly rather than trying to amend the Derivative Benefits test we would propose the inclusion of a special category of “qualified person” to deal with the securitisations industry.

4. **Proposals re new treaty provisions on special tax regimes**

**General comments**
IDSA was surprised to see an entirely new proposal for ‘special tax regimes’ introduced to Action 6. This new proposal comes at a very late stage in the consultation process. In IDSA’s view, this late proposal has the potential to undermine the public consultation process, which stakeholders have been engaged in since the commencement of Action 6. This is particularly true where stakeholders have been requested to make as few comments as possible on revised Action 6 proposals. In IDSA’s view, there are many technical tax issues that need to be dealt with in the ‘special tax regime’ proposal (mentioned below), though all of these are superseded by the requirement for proper consultation on the issues and time to allow stakeholders to properly consider the draft proposals. In this regard, IDSA suggests that no final decision should made on this proposal until 2016, after a full consultation has taken place.

**Difficulties with the ‘special tax regime’ proposal**
Although IDSA believes that stakeholders have not had sufficient time to consider the potential impact of the ‘special tax regime’ proposal, there are some general issues which may be highlighted at a high-level at this stage.

The ‘special tax regime’ proposal is a wholly subjective concept. There are no objective benchmarks as to what a tax regime has to be compared with. In the absence of such objective criteria, taxpayers and tax authorities are likely to attempt to evaluate qualitative differences between their local and foreign tax regimes to decide if a foreign tax regime is ‘special’. Taxpayers and tax authorities will inevitably adopt conflicting positions with respect to the same foreign tax regime. A taxpayer or tax authority (as the case may be) may consider a particular foreign tax regime to be ‘special’, though another taxpayer or tax authority may not. This will result in an inconsistent approach amongst taxpayers (including taxpayers in the same OECD jurisdiction) and an inconsistent approach amongst different OECD tax authorities, in each case with respect to the same taxpayer.

In addition, taxpayers and tax authorities will have to decide for themselves what qualitative differences make a foreign tax regime ‘special’. Although it is not possible to foresee all of the differences that may be considered relevant, some obvious questions are whether a foreign tax regime could be ‘special’ compared to another tax regime simply because it has:

- different tax depreciation regimes;
- different rules for claiming specific tax deductions (eg, financing expenses); and
- local tax exemptions for items of income which may not be relevant to the particular item being considered for treaty benefits.

To decide if there are qualitative differences between tax regimes, taxpayers and tax authorities are likely to need detailed information about the taxpayer in the other jurisdiction. It is difficult to see
how this (often commercially sensitive) information could be obtained in unrelated party transactions.

In addition, the proposal also implicitly assumes perfect knowledge amongst taxpayers and tax authorities as to how all foreign tax regimes operate. In practice, this is an unrealistic assumption and implementing the special tax regime proposal would require taxpayers and tax authorities to obtain detailed information and advice as to how a particular foreign tax regime may apply to particular items of income. This is obviously an impractical and unworkable model.

Finally, OECD jurisdictions differ in the way their tax regimes are constructed. For example, some jurisdictions may have specific tax regimes for particular items of income, whereas others may have a comprehensive tax regime that applies generally, though with some specific provisions for particular items of income. How is a taxpayer or tax authority to determine whether a particular tax regime is special in each of these contexts?

**Scope is not clear**

IDA also believes that the potential scope of the ‘special tax regime’ proposal is not clear. In particular, Action 6 proposes that treaty relief would only be denied if the taxpayer is subject to a special tax regime:

- “with respect to” interest, royalties or other income. It is not at all clear when a regime will be considered to apply “with respect to” any particular item of income. For example, would receipts of interest, royalties or other income have to be exempt from tax or subject to an entirely different tax regime than other items of income?
- that “disproportionately benefit interest, royalties or other income or any combination thereof”. Again, it is not clear what this means. Would the tax regime have to be a completely different tax regime that applies solely to these items of income?

Detailed explanations and commentary would be required to define the scope of the ‘special tax regime’ proposal to provide certainty for taxpayers and tax authorities. As mentioned above, some jurisdictions may have specific tax regimes for particular types of income, whereas others may have a comprehensive tax regime that applies generally. It is not clear how the proposed scope of the ‘special tax regime’ proposal as described above could be applied in these different contexts.

**Unclear how exclusions may work**

Action 6 proposes that Contracting States will be permitted to carve particular local provisions out of the ‘special tax regime’ proposal. However, Action 6 proposes that this would only be possible if the relevant local provisions do not result in a low effective rate of taxation. It is not clear how any carve-out proposal could work in practice, as a special tax regime (by its very nature) is likely to result in a lower effective tax rate than usual.

**EU law**

The ECJ has already concluded (in Case C-318/10) that local tax rules that determine the tax treatment of a payment made in one EU Member State by reference to the characteristics of the tax system of another EU Member State are contrary to European law. In this regard, any proposal relating to special tax regimes could not be applied to tax treaties between EU Member States.
**IDSA proposals**

IDSA proposes that no final decision should be made on this special tax regime proposal until 2016, after a full consultation has taken place with stakeholders on the issues involved. However, if this proposal is to be advanced in its current form, IDSA has some recommendations as to how it might be improved.

1. Related parties; - The ‘special tax regime’ proposal should be limited to payments between related parties only. This is the proposed approach to be applied in the US model tax treaty. This reflects a more sensible approach as it is unlikely to require the taxpayer or tax authority to obtain detailed information about the recipient’s tax status (which, in an unrelated party context, is unlikely to be available).

2. Securitisation vehicles, together with other Non-CIV funds, should be carved-out of any special tax regime provision. This would allow Contracting States to decide for themselves whether securitisation vehicles should be subject to any limitations under applicable tax treaties. Any different approach would undermine existing proposals to treat Non-CIV funds in this way under proposed LOB provisions.

Yours faithfully,

GARY PALMER
Chief Executive
Irish Debt Securities Association
36 Upper Fitzwilliam St.
Dublin 2
Ireland
Mexico City, April 22, 2016

Via email
taxtreaties@oecd.org

Tax Treaties, Transfer Pricing and
Financial Transactions Division

OECD/CTPA

Dear Secretariat,

On behalf of IFA Grupo Mexicano, A.C. (Mexican branch of the International Fiscal Association), below you will find our comments on the consultation document on issues and suggestions on the tax treaty entitlement of non-CIV (Collective Investment Vehicle) funds. Comments appear in *italics* following the questions.

**SUGGESTION THAT TREATY BENEFITS BE GRANTED TO REGULATED AND/OR WIDELY-HELD NON-CIV FUNDS**

1. What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

   *We suggest following Australia’s “widely held rules” for Managed Investment Trusts which state, for instance, that if one of the criteria below is satisfied, the fund should be deemed widely held:*

   - The fund is listed on an approved market stock exchange;
   - The fund has at least 50 members; or,
   - One or more specified ‘widely held’ entities together hold more than 25% of the participation interests in the fund, and no other type of single entity holds more that 60% of the ‘participation interests’ in the fund.

2. What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal?

   *The AIFMD was aimed to increase investor’s protection and reduce systemic risk by establishing a harmonized regulatory framework in the European Union for Alternative Investment Funds managers. These provisions include:*
risk management requirements, depositary requirements, compensation requirements and prudential capital requirements.

This regulatory framework results applicable when managing or marketing alternative funds in or from the European Union, regardless of the fund’s domicile and involves disclosure, transparency and private equity requirements, among others.

Therefore, we believe that any type of regulatory framework that contains disclosure provisions, transparency and private equity requirements that are substantially similar to those included in the Alternative Investment Fund Managers Directive (AIFMD) should be acceptable in order to conclude that a fund is “regulated”.

Other regulatory frameworks that would be acceptable to conclude that a fund is “regulated” for the purposes of such a proposal could be the following:

- Genuine diversity of ownership principle
- UCITS Directive
- CB UCITS Regulations in Ireland
- REITs Regulatory Framework in the US, Singapore, etc.
- ASEAN CIS fund passport mechanism
- Regulation of managed investment schemes in Australia
- Hong Kong/China mutual fund recognition platform
- Etc.

For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

Yes

3. Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

It is worth mentioning that investors are usually not motivated by tax-driven reasons when deciding to invest in non-CIVs. Their main driver is usually to diversify risk across international markets and benefit from reduced costs and
economies of scale as well as the market experience of professional managed funds. These non-tax reasons generally outweigh any tax-motivated purpose.

Moreover, a significant ratio of non-CIVs’ investors are institutional investors that are resident in treaty countries and usually tax exempt.

In order to address treaty-shopping concerns we recommend setting a threshold of ownership by equivalent beneficiaries. The threshold could be established and agreed to in each treaty (e.g., ranging between 80% and 90%).

4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

Investors in a non-CIV are usually in for long-term investments, such as in pension funds; therefore, we believe that mandatory distribution requirements for a fund to be eligible for the proposed exception would not be feasible. However, we believe that since non-tax reasons generally outweigh any tax-motivated purpose in these types of investments, a bona fide clause should be set in place.

5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

By incorporating more requirements for a non-CIV to qualify for the exemption, such as “widely held rules” and being subject to an AIFMD-like regulatory framework. Incorporating a “Bona fide clause” could also be helpful.

6. One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?
No comment.

NON-CIV FUNDS SET UP AS TRANSPARENT ENTITIES

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

Considering that regulated non-CIVs must meet disclosure provisions and transparency requirements, and considering the global trend to adopt anti-laundering provisions and “know your customer” rules, we believe that there should not be material problems that could prevent the application of the new transparent entity provision.

SUGGESTION THAT THE LOB INCLUDE A DERIVATIVE BENEFIT RULE APPLICABLE TO CERTAIN NON-CIV FUNDS

Questions related to certain aspects of the proposal

8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context?

We deem fit to define institutional investors as non-bank persons or organizations that trade securities in large enough share quantities. Examples of “institutional investors” could be the following: public and private pensions, retirement plans, insurance companies, university endowment funds, health care endowment funds, sovereign wealth funds and charitable investment funds, among others. It is worth mentioning that these represent the primary investors in non-CIV funds.

In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that
might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

Yes, since their non-tax reasons generally outweigh any tax-motivated purpose.

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

The main types of non-CIV Funds are Alternative Investment Funds, Real Estate Investment Trusts, Sovereign Wealth Funds, pension funds, private equity funds, hedge funds, among others.

10. Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

No comment.

11. What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?

Making investments to diversify risk across international markets and benefit from reduced costs and economies of scale.

12. How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

By meeting rules similar to the genuine diversity of ownership condition (GDO).

Questions related to the identification of the investors in a non-CIV

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

No comment.

14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their
ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

No comment.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

No comment.

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

No comment.

Questions related to the prevention of treaty-shopping

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

Consideration should be given to including a subject-to-tax test applicable for the beneficial owner.

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a
20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

Consideration should be given to providing treaty benefits solely to the investors that are deemed equivalent beneficiaries (without the need of establishing an ownership threshold).

19. One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

No comment.

Questions related to the prevention of deferral

20. According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met?

By including a subject-to-tax test (i.e., a sworn statement by the legal representative).

Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

No comment.

21. As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

The beneficial owner.
Questions related to the new derivative benefits provision of the United States Model

22. The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016 (see https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-206.pdf, paragraph 4 of Article 22 “Limitation on Benefits”). Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

We believe that this provision should be removed and solely rely on the equivalent beneficiaries test.

SUGGESTION THAT A “SUBSTANTIAL CONNECTION” APPROACH BE ADOPTED

23. Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

No comment.

SUGGESTION OF A “GLOBAL STREAMED FUND” REGIME

24. Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?

What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

No comment.

**ADDITIONAL EXAMPLES FOR THE COMMENTARY ON THE PPT RULE**

25. Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

No comment.

**CONCERNS WITH RESPECT TO CONDUIT ARRANGEMENTS**

26. Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

No comment.
CONCERNS RELATED TO THE “SPECIAL TAX REGIMES” PROPOSAL

27. Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released in February 2016 (see question 22 above). If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

   No comment.

OTHER SUGGESTIONS

28. Please describe briefly any approach not already mentioned in this consultation document or in previous comments that could address concerns related to the way in which the new treaty provisions included in the Report on Action 6 may affect the treaty entitlement of non-CIV funds without creating opportunities for treaty-shopping or tax deferral.

   No comment.

*   *   *

The participation of IFA Grupo Mexicano, A.C. is made on its own behalf exclusively as an IFA branch and in no case in the name, or on behalf, of Central IFA or IFA as a whole.

We hope you find these comments interesting and useful. We remain yours for any questions of comments you may have.

Sincerely,

IFA Grupo Mexicano, A.C.
Dear Sir/Madam

Introduction

The Institutional Limited Partners Association (ILPA) appreciates the opportunity to respond to the Public Discussion Draft issued by the OECD on 24 March 2016, in order to address the outstanding issues relating to the treaty entitlement of non-collective investment vehicle (CIV) funds.

About the ILPA

The ILPA is a global organisation dedicated to the interests of institutional investors into private equity (PE) funds worldwide (known as Limited Partners), and one that is committed to promoting tax transparency and fairness in the operating practices of its member firms. We therefore support the broad objectives of the OECD’s Base Erosion and Profit Shifting (BEPS) project.

Our membership comprises more than 3,000 investment professionals from 32 countries around the world across 333 organisations, ranging from insurance companies, pension funds, public sector funds, foundations and endowments, collectively representing more than €1 trillion in PE assets under management globally. The ILPA’s membership constitutes approximately half of all institutional capital being invested into private equity globally.

As a representative body, we speak exclusively on behalf of Limited Partners from around the world, and are very happy to now be presented with the opportunity to provide feedback on this latest consultation under Action Point (AP) 6 of the BEPS project on Treaty Abuse.

We intend to pitch our comments at a high level in this context, as we do not fundamentally disagree with any of the technical representations made by industry to date, such as in past submissions made
by Invest Europe\textsuperscript{1} and the Private Equity Growth Council\textsuperscript{2}, both of which were summarized in the Revised Public Discussion Draft as of 22 June 2015.

We hope that our input will be of use to the OECD in its work to find a suitable compromise that maintains the integrity of the BEPS process, while ensuring that the ILPA’s members can continue to invest into non-CIVs, and consequently, the real economy in a competitive fashion.

\textbf{Our response}

We will not address each and every question posed by the OECD in this latest Public Discussion Draft, instead focussing on the key issues as we see them for the ILPA membership.

If it would be helpful for the OECD to discuss any of the points raised here in further detail please do not hesitate to get in touch, as we would be delighted to provide further elaboration in person if you should so require.

Kind regards,

Jennifer Choi
Managing Director, Industry Affairs
Institutional Limited Partners Association (ILPA)
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OECD Public Discussion Draft on the Treaty Entitlement of Non-CIV Funds

We believe it appropriate to first provide some commentary on each of the two points of principle the OECD is seeking to address in the context of non-CIVs under AP6.

Page 3 of this latest OECD Discussion Draft states that Member States have two general concerns here:

- First, that non-CIV funds may be used to provide treaty benefits to investors that are not themselves entitled to them; and,
- Second, investors may defer recognition of income on which treaty benefits have been granted.

Private equity (PE) funds exist to provide patient capital committed for the long term (the average holding period of a standard PE-backed portfolio company is usually between three and seven years), which complements the availability of debt finance typically offered by banks in the economy. This supports economic growth, financial stability, and security for those businesses and individuals who rely on a steady income stream, particularly retirees holding policies with pension funds or insurers providing an annuity.

In order to achieve this, PE funds channel institutional money – whether it is coming from potentially tax-exempt Limited Partners such as pension funds, charities etc., or those that are subject to domestic tax such as insurers or family offices – into growing companies that in turn generate for investors and their ultimate beneficiaries a meaningful return. As of December 31 2015, PE and venture capital (VC) investments into European privately held companies generated for institutional investors 10-year returns of 11.74% on average, compared with 5.3% and 3.2% returned in the public markets over the same period, according to the MSCI World and MSCI Europe indices respectively.3

From the ILPA’s perspective, it is not the purpose of non-CIVs to provide treaty benefits to those investors who are not eligible to receive them, rather it is to provide a mode for investors to channel capital into undervalued and/or high growing companies in Europe and elsewhere, regardless of where that individual investor may sit, in a way that maximizes the return on their investment, and preferably without adding undue tax liability beyond which they are not otherwise subject in their home jurisdictions.

PE funds are dependent upon raising capital from a wide variety of institutional investors in different jurisdictions around the world, in order to achieve requisite economies of scale. Of course, the respective treaty eligibility status of each of the investors that allocate capital to the fund – which is then available to the manager for draw-downs and subsequent portfolio investments – is not uniform (although a majority would typically be able to access treaty relief had they allocated directly to an end investment).

This state of affairs should not prevent treaty access however and was in effect, recognized by the OECD as part of its 22 May 2015 Revised Discussion Draft on Treaty Abuse, via the notion of an expanded derivative benefit provision under a simplified Limitation on Benefit (LOB) test4.

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3 Sources: ILPA/Cambridge Associates LLC and MSCI Inc. The ILPA Private Markets Benchmark is an end-to-end calculation based on data compiled from 3,413 funds formed between 1981 and 2015. Figures indicate pooled end-to-end return, net of fees, expenses and carried interest as of 30 September 2015.

4 A resident of a Contracting State that is not a qualified person shall nevertheless be entitled to a benefit that would otherwise be accorded by this Convention with respect to an item of income if persons that are
Although we welcome the direction of policy travel towards a more accommodating stance by the OECD, it remains the view of the ILPA and its membership that it would represent a considerable burden of compliance for non-CIV managers to meet the criteria of such a test. The additional cost this would inevitably generate would then be passed on to institutional investors and their ultimate beneficiaries. While reporting does naturally take place under existing regulatory frameworks including the US Foreign Account Tax Compliance Act (FATCA), and forthcoming regimes such as the OECD’s own Common Reporting Standard, neither extends to recording the treaty eligibility status of all investors. Mandating the collection of such information would represent a disproportionate compliance burden for both non-CIV managers and LPs, and one that in practical terms would be very difficult to meet.

It is for this reason that greater flexibility is needed in the context of the LOB test, while we would request more clarity insofar as the General Anti-Abuse Rule (based upon a Principal Purpose Test) is concerned so as to maintain tax neutrality for institutional investors allocating to non-CIVs.

The ILPA believes that the alternative – tax exempt investors facing undue taxation when allocating via a non-CIV, and LPs that do have a domestic tax liability exposed to the prospect of double taxation – would be excessive and could have a cooling effect on institutional investor interest in circumstances where such risk of undue or double taxation were present.

We also feel it is of use to stress that since the financial crisis of 2007-8 and subsequent sovereign debt crisis in Europe, the spotlight of public scrutiny on the tax affairs of all parts of the financial services industry has intensified considerably.

The PE industry is no exception, and as such the reputational risk of engaging in any sort of activity that could be construed as aggressive tax avoidance, while far from palatable prior to the last economic shock, is even less so now.

Finally, PE funds are actively incentivized to deliver accrued returns to institutional investors, a state of affairs we believe limits the possibility of non-CIVs being used in this regard to defer recognition of income. Institutional investors into PE funds rely on distributions from these investments to smooth their overall returns, and contribute to their ability to fund their ongoing liabilities, whether that means payouts on benefits to retirees or to policyholders, or for the operational funding of educational or charitable institutions. As such, the precise terms around the timing and conditions for distribution of net cash owed to investors are laid out in the fund agreements. It is unthinkable that investors would tolerate returns generated on the basis of their invested capital, and which are contractually owed to them, to be artificially warehoused in offshore vehicles for the tax benefit of the managers of these non-CIVs.

In fact, the ILPA has recommended that all capital returning to the fund from the harvesting of investments be distributed back to institutional investors until all called capital has been returned, inclusive of any offset fees or fund expenses, and the hurdle rate of return has been met. Only then should General Partners retain their share of excess returns above the hurdle rate, known as carried interest, generated by the capital invested via the non-CIV.

equivalent beneficiaries own, directly or indirectly, more than 75 per cent of the beneficial interests of the resident."
Concerns related to the Limitation on Benefits (LOB) provision

The ILPA recognises the majority of concerns flagged by the private equity industry to date in regards to the draft LOB provision.5

The LOB rule as worded in previous OECD drafts would be essentially impossible for a PE fund to meet. Of course, the form of the final provision remains the topic of discussion here, and we welcome the fact that the OECD still appears to be considering all options in a bid to find a palatable solution for non-CIVs.

As stated above, we are appreciative of the OECD’s willingness to sanction the introduction of greater freedom into the model treaty in this regard, but must stress that even a simplified LOB would represent a considerable administrative challenge. The ILPA would therefore encourage the OECD to continue with the direction of travel started with the simplified LOB, originally floated back in mid-2015 and introduce further flexibility that caters for non-CIV access to international taxation treaties while still respecting the integrity of the BEPS initiative.

More generally, an excessively restrictive approach in this field could have an extremely detrimental effect on the attractiveness of PE as an asset class for international Limited Partners. The commensurate reduction in capital flows could have significant knock-on effects for both the companies that rely on such equity investment, and for example, individuals that hold policies with institutional investors such as pension funds and insurers. The ILPA’s members in these two categories manage invested capital totalling EUR575 billion in private equity backed companies globally, EUR100 billion of which has been invested by European insurers and pension funds.

General Anti-Abuse Rule

While in principle we welcome the more qualitative approach offered by a General Anti-Abuse Rule or PPT, we do remain concerned that the final wording remains overly broad, and may lead to uneven implementation into national taxation treaties.

In regards to “Discretionary Relief”, the OECD’s Final Report on AP6 from October 2015 stated the following:

“A resident of a Contracting State that is neither a qualified person nor entitled under paragraph 3 or 4 to a benefit that would otherwise be accorded by this Convention with respect to an item of income shall nevertheless be entitled to such a benefit if the competent authority of the Contracting State from which the benefit is being claimed, upon request from that resident, determines, in accordance with its domestic law or administrative practice, that the establishment, acquisition or maintenance of the resident and the conduct of its operations are considered as not having as one of its principal purposes the obtaining of such benefit [emphasis added]. The competent authority of the Contracting State to which such request has been made by a resident of the other Contracting State shall consult with the competent authority of that other State before rejecting the request.”

5 See previous reference to prior submissions by the Private Equity Growth Capital Council and Invest Europe.
We note that the specific wording highlighted here – particularly “one of its principal purposes” – is already being adopted around the world, with the European Commission’s Recommendation on the Implementation of Measures against Tax Treaty Abuse\(^6\) from January 28 2016 containing essentially the same text.

At this point the ILPA would simply like to highlight that both international Limited Partners and the fund managers to which they allocate consider a whole host of factors when deciding upon every step of an investment; thorough due diligence is a hallmark of the industry and a requirement for investors in fulfilling their fiduciary obligations. A failure to scrutinise each investment could jeopardise returns. A high-level analysis of taxation treaty network may well be one of many considerations taken into account by a PE fund manager when considering when and where to make a transaction but this does not mean it is a “principal purpose”, let alone the principal purpose.

Discretion is granted to Competent authorities when it comes to interpreting this provision, but it would be very helpful if the OECD were to provide additional clarification so as the competitive reality of PE investments is not threatened by a broad PPT.

**Conclusion**

As has been well documented, the OECD confirmed in October 2015 in its Final Report on AP 6 that it “recognises the economic importance of these funds [non-CIVs] and the need to ensure that treaty benefits be granted where appropriate”\(^7\).

We hope our input will prove useful to the OECD in terms of finding a workable compromise in this area that will enable non-CIVs, particularly PE funds, to continue making this valuable economic contribution.

For the purposes of clarity, please see below a list of our key concerns in this context:

- We at the ILPA hope that a balance can be found by the OECD that prevents institutional investors from being placed in a competitively worse-off position from a tax perspective when allocating to a PE fund, than if they had invested directly in its underlying assets.
- We believe the avoidance potential of PE non-CIVs is limited, and therefore encourage the OECD to review the LOB test in particular in a bid to ensure legitimate investment activity in this regard can continue.
- It is the view of the ILPA’s membership that an excessively restrictive approach could have a chilling effect on international flows of investment.

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Date: 22 April 2016

Subject: INREV’s response to OECD’s “Public Discussion Draft Treaty Entitlement of Non-CIV Funds”

Dear Sirs,


We hope again to provide a meaningful contribution to your work to support the development of a sound regulatory framework and remain available should you have any specific questions about the non-listed real estate fund industry.

Kind regards,

Matthias Thomas
Chief Executive INREV

Attachment:
INREV’s response to OECD’s “Public Discussion Draft Treaty Entitlement of Non-CIV Funds, 24 March 2016”

Submitted via email: taxtreaties@oecd.org
About INREV: the voice of the European non-listed real estate investment industry

INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance, research and information related to the development and harmonization of professional standards, reporting guidelines and corporate governance within the non-listed property funds industry across Europe.

INREV currently has 383 members. Our member base includes institutional investors from around the globe including pension funds, insurance companies and sovereign wealth funds, as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into non-listed real estate vehicles in Europe.

Our fund manager members manage more than 500 European non-listed real estate investment funds, as well as joint ventures, club deals and separate accounts for institutional investors. INREV’s members represent almost all jurisdictions of the European Union’s internal market and a range of underlying long-term investment vehicle structures, such as Joint Ventures, Club-Deals, Non-CIVs and other non-listed real estate investment vehicles, the vast majority of which are Alternative Investment Funds (“AIFs”) subject to regulation under the European Alternative Investment Fund Directive (“AIFMD”).

Comments regarding the Discussion Draft on Treaty Entitlement of Non-CIVs

INREV welcomes the opportunity to comment on the recent OECD Public Discussion Draft: Treaty Entitlement of Non-CIV Funds (the “Public Discussion Draft”). We are very pleased that the OECD seeks the view of the stakeholders in the investment management industry in order to find appropriate solutions non-CIVs in connection with the work on BEPS Action 6 – Treaty Abuse. In paragraph 4 of the Introduction of the Public Discussion Draft two main concerns about granting tax benefits with respect to non-CIV funds are stated:

(i) Non-CIV funds may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits, and

(ii) Investors may defer recognition of income on which treaty benefits have been granted.

In order to find ways to address these concerns the Public Discussion Draft raises a number of specific questions.

In this document INREV will address the concerns raised and answer the questions as far as they are relevant in the context of real estate non-CIV funds. INREV believes that the concerns raised in relation to granting treaty benefits to non-CIV funds are not relevant to non-CIV real estate funds due to the specific tax treatment of real estate investments under the tax laws of the source state which is supported by article 6 of the OECD Model Tax Convention on Income and Capital (Model Treaty). Therefore, and as further elaborated below, INREV believes that a specific carve-out for non-CIV real estate funds is justified and that such funds should pass the PPT test.

No treaty abuse and tax deferral in the case of non-CIV real estate funds

INREV would like to emphasise the purpose and the unique tax position of non-CIVs investing in real estate (“Real Estate Non-CIVs”). As explained further below, Real Estate Non-CIVs cannot be used to provide treaty benefits to investors to which they are otherwise not entitled and/or to defer income.
The primary commercial purpose of Real Estate Non-CIVs is to enable collective investment in real estate assets for the account of multiple investors. As we have stated in previous submissions\(^1\), we believe that BEPS Action 6 should put investors in Real Estate Non-CIVs in the same tax position that they would be in if they had invested in the underlying real estate assets directly. We emphasise that this goal is in line with the policy defined by the OECD in the 2010 CIV report. In other words, there should be tax neutrality between a direct investment in real estate and an investment in real estate via a non-listed real estate vehicle including a Real Estate Non-CIV.

Income derived from a direct investment in real estate is generally taxed at the level of the investor owning the real estate asset through imposition of (corporate) income tax. However, countries where the real estate assets are located typically do not impose other taxes on this income. As a result, there is generally no difference in the tax treatment of an investor that invests in real estate in its home state and an investor that invests in real estate in another state. To avoid double taxation, the investor’s home state exempts this income earned on real estate in another state from (corporate) income tax in accordance with article 6 of the Model Treaty. In contrast to income from other asset classes, the Model Treaty does not restrict source states in their right to levy tax on real estate income – see also section 6 and section 13(4) of the Model Treaty.

Pooling real estate investments through a Real Estate Non-CIV does not limit the right of the source state to levy (corporate) income tax. The only consequence of interposing a Real Estate Non-CIV is that the source state exercises its taxing right at the level of the Real Estate Non-CIV (or a subsidiary of such Real Estate Non-CIV), rather than at the level of the investor.

We note that this method of taxation of real estate income forms a significant difference with other types of income such as dividends, interest or royalties, as these types of income typically are subject to a withholding tax levied by the source state.

Following this significant difference in the tax treatment of income derived from real estate, it cannot be said that Non-CIVs investing in real estate “may be used to provide treaty benefits to investors that are not themselves entitled to the same treaty benefits”. Therefore one of the main concerns underpinning BEPS Action 6, which is that Non-CIV funds may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits, does not apply to Real Estate Non-CIVs.

Despite this fact, treaty access is still important for the appropriate functioning of Real Estate Non-CIVs. This can be explained by the fact that a Real Estate Non-CIV generally holds its real estate investments through one or more (controlled) special purpose companies. The primary role of these special purpose companies is generally to ensure isolation of the liabilities of and potential legal claims against each asset or relatively small group of assets. Especially real estate investments that are financed with external debt need to be ring-fenced because of the potential liabilities relating to the external financing arrangements.

To secure the tax neutrality of Real Estate Non-CIVs, it is important that the interposition of such special purpose companies does not cause an additional tax burden that would not arise if the investments where held directly. In this sense, the application of tax treaties is crucial for achieving tax neutrality for Real Estate Non-CIVs as a whole – i.e. including their (controlled) special purpose companies.

In addition, with regard to the second main concern underpinning BEPS Action 6 proposals, that investors may use Non-CIVs to defer recognition of income, we emphasise that Real Estate Non-CIVs cannot be used for the deferral of taxation. This point is clear because, as noted above, source states secure the immediate taxation of real estate income pursuant to their taxing rights under the Model Treaty.

Conclusion

INREV believes that neither treaty shopping nor tax deferral is the purpose of a Real Estate Non-CIV, given the unique tax profile of real estate as described above. Further, INREV believes that unrestricted access to tax treaties for Real Estate Non-CIVs and their (controlled) special purpose companies is justified in order to achieve tax neutrality consistent with the OECD 2010 CIV report.

Suggestions related to the LOB provisions

INREV recommends that treaty benefits be granted to Non-CIVs (including its directly or indirectly wholly owned entities established in the same jurisdiction) that fulfil the following cumulative conditions:

a) More than 50% of the value of the Non-CIV shares is derived directly or indirectly from immovable property (real estate) that is held by the Non-CIV or directly or indirectly controlled entities of the Non-CIV (n.b., this wording follows article 13(4) of the OECD Model Tax Convention on Income and Capital); and

b) At least 80% of the shares in the Non-CIV are held by professional (non-individual) investors such as insurance companies, pension funds, sovereign wealth funds, non-profit organisations, other Non-CIVs qualifying as Real Estate Non-CIVs, and their controlled entities.

INREV has the following comments to the questions relating to the suggestion that treaty benefits be granted to regulated and/or widely held Non-CIV funds:

Question 1: What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

As explained above, a Real Estate Non-CIV cannot be used to further treaty abuse. The widely held requirement should not apply to Real Estate Non-CIVs.

Question 2: What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the
types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

We do not consider that regulation should be a condition for treaty access. In particular, it is not clear how the regulatory requirements identified in the question would provide any protection against treaty abuse or tax deferral; and as such, we do not recommend that regulatory criteria should be introduced.

Question 3: Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

As explained above, a Real Estate Non-CIV cannot be used to further treaty abuse. The concerns regarding treaty shopping should not apply to Real Estate Non-CIVs.

Question 4: Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

As explained above, a Real Estate Non-CIV cannot be used for deferral of income. The proposals regarding immediate distribution of earnings should not apply to Real Estate Non-CIVs.

Question 5: States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

Given the specific tax treatment of income from real estate (exclusive and unlimited taxation in source state, not restricted by tax treaties), states should not be concerned that taxation is limited to corporate income tax in source state.

Question 6: One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment
is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

Income from real estate is not subject to withholding tax. Therefore, there is no intermediary level tax if a Real Estate Non-CIV holds real estate directly. For legal and commercial reasons Real Estate Non-CIVs use special purpose vehicles in the form of limited liability companies to hold real estate assets. These special purpose entities are typically funded with a mix of equity, third party debt and related party debt.

INREV has the following comments to the questions relating to the suggestion that the LOB include a derivative benefit rule applicable to certain Non-CIV funds:

Question 8: The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

The principal purpose of Non-CIV funds, like collective investment vehicles generally, is to allow investors to pool capital and gain efficient access to professional management and diverse assets. Access to treaty benefits is not a principal purpose of Non-CIV funds, although treaty benefits may be necessary to prevent investors from suffering an additional layer of tax due to their investment through a Non-CIV fund. Obtaining tax neutrality is a consequence of the investment and not a main purpose of it, and is not to be regarded as treaty shopping.

Question 9: Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

A Non-CIV fund would be, in the absence of further definition, any collective investment scheme which is not a CIV. CIVs are defined as “funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection legislation in the country in which they are established.” Non-CIV funds would therefore cover a spectrum from fully regulated funds that do not qualify as CIVs only because they invest wholly or to some extent in investments other than securities, to alternative investment funds for “professional” or “sophisticated” investors, which do not require the same levels of investor regulation. These Non-CIV funds may be open-ended or closed-ended (with or without a fixed life), they may be companies, partnerships or other entities in legal form, and they may be tax transparent or not.
INREV has the following comments to the suggestion of a “global streamed fund” regime:

Question 24: Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

i) Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
ii) Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
iii) Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
iv) What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

As explained above, a Real Estate Non-CIV cannot be used to further treaty abuse. Therefore, a global streamed fund, if adopted, should not apply to Real Estate Non-CIVs.

INREV has the following comments to the concerns related to the PPT rule:

Question 25: Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

INREV strongly believes that treaty shopping and/or tax deferral is not the purpose of a Real Estate Non-CIVs. Our opinion is based on the fact that real estate income is not subject to withholding tax; however it is subject to (corporate) income tax in the source state. As such, (corporate) income tax is levied immediately upon generation of the income and tax is also not deferred. We recommend adding Real Estate Non-CIVs that fulfil the following requirements as an example of a legitimate arrangement:

a) More than 50% of the value of the Non-CIV shares is derived directly or indirectly from immovable property (real estate) that is held by the Non-CIV or directly or indirectly controlled entities of the Non-CIV (n.b., this wording follows article 13(4) of the OECD Model Tax Convention on Income and Capital); and

b) At least 80% of the shares in the Non-CIV are held by professional (non-individual) investors such as insurance companies, pension funds, sovereign wealth funds, non-profit organisations, other non-CIVs qualifying as Real Estate Non-CIVs, and their controlled subsidiaries.
Dear Sir or Madam

Treaty entitlement of non-CIV funds

The Investment Association welcomes the opportunity to respond to the OECD’s consultation document on the treaty entitlement of non-CIV funds.

As we have stated in our previous responses to BEPS 6 consultations, non-CIV funds provide significant social benefits. Non-CIV funds provide vital source of capital to companies, particularly to small and medium businesses, and provide significant capital (often invested across borders) to infrastructure projects, property development and other economic activities.

It is vital that institutions and individuals that pool their investments through funds (whether CIVs or non-CIVs) should be able to obtain the same tax treatment as if they had invested directly in the underlying assets. Without this neutrality of tax treatment, funds would be unviable.

The exclusion of non-CIV funds from obtaining treaty benefits is a barrier to cross border capital investment, and could ultimately deprive businesses and governments of vital capital.

Our responses to the questions in the consultation are in the annex to this letter. If you would like to discuss any of the points made, I’m available at jorge.morley-smith@theia.org or on +44 (0)20 7831 0898.

Yours faithfully,

Jorge Morley-Smith
Director

Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development

By email: taxtreaties@oecd.org

Date: 22 April 2016
ANNEX

CONSULTATION RESPONSE

ABOUT THE INVESTMENT ASSOCIATION

The Investment Association is the trade body that represents UK investment managers, whose 200 members collectively manage over £5.5 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people’s resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 37% of European assets.

More information can be viewed on our [website](#).

TREATY ENTITLEMENT OF NON-CIV FUNDS

**Suggestion that treaty benefits be granted to regulated and/ or widely-held non-CIV funds**

One of the key issues is defining the scope of any work on non-CIV funds. Our starting premise is that a non-CIV fund is any fund that is not a CIV, as defined in the 2010 CIV report – funds that are widely held, hold a diversified portfolio of securities and are subject to investor protection regulation in the country in which they are established (para. 4, 2010 Report).

What funds fall within the classification of CIV should be a matter for contracting parties of a tax treaty, and we believe that the MTC should not attempt to provide a more detailed definition of a CIV. We believe that references to specific types of funds (EU AIFs, QIAIFs, etc) are unhelpful, and contracted parties should agree the extent to which these and other funds meet the characteristics in the MTC.

Non-CIVs are therefore funds that do not meet all of these characteristics and we believe that the MTC should consider how treaty access might be granted to funds or their investors when the funds don’t have the characteristics of being widely held, regulated and diversified.
Of course, it is possible for a non-CIV fund to meet some but not all of the characteristics – for example, a widely held hedge fund that is not diversified, nor subject to investor protection regulation in its country of establishment. However, given the diversity of non-CIVs, there would be so many permutations of possible treaty treatment for funds with different characteristics that we have not considered this point further.

**Non-CIV funds set up as transparent entities**

**Question 7.** Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

We support the idea that non-CIV should be able to elect to be treated as fiscally transparent for treaty purposes, but we concur that it is not a matter for treaties themselves.

We also note that for practical reasons to do with the reporting of income and gains entitlements, this will be appropriate only for a subset of non-CIVs (for example, those whose investors are restricted to institutional investors that are not subject to capital gains tax, or those that are closed-ended). We do not believe that full transparency will be a viable option for funds with a broad base of diverse investors. We believe that in most cases, the problems related to the identification of underlying investors should be manageable, and are becoming more so because of the increasing investor identification requirements of CRS and AML.

However, we would strongly support clear guidance on the type of documentation that should be required by source countries granting treaty benefits to investors in fiscally transparent funds. In particular this should build on the self-certification approach adopted by TRACE and the CRS, and should be facilitated through intermediaries (including the funds themselves where necessary).

More broadly, we strongly support the implementation of TRACE and note that this is a further example of the possible benefits of TRACE to funds (CIVs and non-CIVs) and their investors.
Suggestion that certain non-CIV funds be granted treaty benefits where a large proportion of the investors in the funds would be entitled to the same or better benefits if they had received the income directly

Our annual survey contains a breakdown of investor types for investment managers that splits retail and institutional investors in the UK as follows.

[Note that investors in the diagram are not exclusively in non-CIV funds – these include all investors, including a majority of CIVs and direct investment clients. However, because non-CIV funds are not normally available for retail distributions, institutional investors are a cornerstone of non-CIV investment.]

MiFID II defines “Professional Client” similarly.

Pension funds, sovereign wealth funds, insurance companies, charities, etc are typically afforded treaty entitlement under most treaties. Institutional investors are usually fewer in number than retail investors, bigger in value of capital contribution and stickier in terms of length of investment horizon and the likelihood to disinvest. This makes them much more practical to document and demonstrate entitlement to treaties. We believe that is a strong public interest in ensuring that these types of investors are able to access the treaty benefits to which they would be entitled outside of a collectivised form of investment.

**Question 9.** Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

We believe that a non-CIV fund should be any fund that is not a CIV. The term ‘fund’ has a number of definitions in regulation and tax (including, for example the Alternative Investment Fund Managers’ Directive (AIFMD)), but we have not considered the merits of any specific definition for these purposes.

The merit of defining specifically what a non-CIV fund is depends on the purpose and function of that definition. The definition of CIV is relevant to the application of subparagraph 2(f) of the LOB clause in the BEPS 6 report, and to applying the Commentary to Article 1 of the MTC.

There is a huge diversity of non-CIVs in legal structure, investment objectives, regulation, investor types etc. Some non-CIVs are structured using a series of legal entities that serve different legal and commercial purposes – for example, some countries require companies owning real property to be established where the property is located.

At a basic level, we believe non-CIVs (and entities that comprise non-CIV structures) should be capable of accessing treaty benefits if they meet the conditions for treaty entitlement (ie resident persons, beneficial owner, and meeting any anti-abuse provision relevant to other persons claiming treaty benefits). So, for example, a company should not be denied treaty access only because it forms part of a structure contained within a non-CIV.
Otherwise a more precise definition of non-CIVs would depend on the purpose and function of the definition.

**Question 10.** Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

We question the need for any specific anti-abuse rules beyond those already incorporated in the BEPS 6 report, and note that a PPT condition already provides safeguards against the use of a non-CIV fund for treaty shopping purposes.

**Question 13.** Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

We do not have data supporting or disproving this view. However investors in non-CIV funds are likely to be professional investors that will have a long term outlook on investment decisions. We also note that retail orientated funds normally require daily liquidity for investors, while this will be less common for non-CIV funds. Private equity, real estate and infrastructure funds often employ closed-ended structures with fixed term lifespans (7 year+) and limited secondary market opportunities that demonstrate it is difficult for investors to take short term positions and only serious investors with a long term view would invest in practice.

**Question 14.** How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

The problem of identifying investors is most common for widely held funds that are CIVs. Whilst some non-CIVs will also be widely held, we have noted above the need for there to be a clear distinction in the MTC between features that are relevant for CIVs and non-CIVs.

Non-CIV funds are generally not available for broad distribution into the retail market. Therefore, even where a non-CIV fund is widely held, its investors are likely to be a discrete number of professional investors.

We believe that developments in regulation and tax, particularly new AML standards of FATF 2012, and the implementation of the CRS, have led to a greater acceptance that information on ultimate beneficiaries can be obtained in order to provide better treaty access for ultimate investors in funds.
**Question 15.** What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

**Question 16.** Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

**Question 17.** Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

Fund managers will be responsible for the identification of investors under AML rules, and in many countries from 1 January 2016, under the OECD Common Reporting Standard.

These rules require the fund manager to identify, and confirm the tax residence of the immediate investor. So where a fund unit is held by an intermediary, only the intermediary will be identified (and the intermediary will itself have responsibility for identifying the ultimate investor, or next intermediary in the chain).

Thus, the information currently obtained by the fund manager will be sufficient to identify treaty entitlement only in some scenarios (for example direct individual investors).

In terms of the intermediation of the distribution chain of funds, the analysis will be the same for CIVs and non-CIVs, and thus the analysis in the 2010 CIV report is relevant to this question in relation to non-CIVs also.

However it is necessary to distinguish between intermediation of the distribution chain (which typically involves unrelated third party distributors) and the fund structures themselves, that in the case of non-CIVs often comprise multiple entities that are related. We do not think fund managers should encounter significant difficulties establishing the treaty eligibility of intermediate entities in a fund structure because the fund manager will often have access to all the relevant information from those entities.
**Question 18.** The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

Most LOB provisions may ultimately allow a proportion of investors that are not themselves be entitled to treaty benefits to access treaty benefits that are conferred to a fund. A high threshold of eligible investors reduces the opportunity for treaty shopping, but this needs to be balanced against the operability of the LOB condition, and its commercial impact.

We believe an 80% threshold should be considered an adequate balance between the operability of treaties, and tackling the risk of treaty shopping, particularly if used in combination with a PPT condition. In particular it ensures that no significant investor in a non-CIV fund can use an investment for treaty shopping.

A possible alternative to this is to grant non-CIVs funds treaty access only in proportion to the eligible investors in the fund. This raises practical difficulties as a result of funds needing either: to commingle treaty benefits amongst investors so that each investor gets a blended allocation of treaty benefits; or to separately price units for each class of investors according to their status under treaties, and changes in investor base would lead to re-documentation.

In some cases we believe these practical issues may be manageable – for example where a fund has only a limited number of investor-types. We believe that it would be worth further exploring granting proportional benefits to non-CIV funds with a view to understanding whether the practical issues can be overcome. In particular we think that a combined approach of derivative benefits for a fund meeting certain thresholds, or proportional granting of treaty benefits in other cases could be a positive (if imperfect) outcome for clarifying treaty entitlement for non-CIVs.

**Question 19.** One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn't the 50% threshold proposed for the base erosion test be too generous? Questions related to the prevention of deferral

As the OECD 2010 CIV report points out, in order to ensure that there is only one level of tax, at either the fund or the investor level, many funds are exempt from tax on income. Thus, the intent is to ensure neutrality between direct investments and investments through a fund. Although in some treaties this may have an impact on whether the fund is a resident under the treaty, this is not always the case, and the base erosion test requires a separate analysis.

Where a fund is exempt from tax on income there is no tax base to erode. For example where such a non-CIV had to make a lot of payments (i.e. more than 50% of the gross income which it has booked) under the derivative contracts which it holds where the counter party is a foreign bank and that foreign bank were not an equivalent beneficiary, there is no base erosion as there is no tax deduction taken. We think it would be helpful if this was clarified.
Question 20. According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

As an example, in the EU a number of countries operate regimes that are designed to prevent investors from being able to accumulate income in funds (Belgium, Germany, Austria and the UK all operate such regimes). Also many countries require certain institutional investors to tax their interests in funds on a trading basis, eg insurance companies writing pension business or, in the case of debt funds, on a mark to market basis rather than a receipts basis so there is no deferral of the income which has been received by the non-CIV being taxed by the equivalent beneficiary.

However, we recognise that tax deferral is a possible outcome for certain investors in a non-CIV fund where the residence country has no anti-deferral tax regime, and therefore it is right that the MTC should reference this when considering the treaty eligibility of non-CIV funds.

However anti-deferral regimes will differ from country to country and it would be extremely complex for each tax treaty to define a list of acceptable anti-deferral regimes worldwide. We would welcome a coordinated approach to defining acceptable anti-deferral regimes – possible with the agreed list of countries operating anti-deferral mechanisms.

More generally, we believe that the proliferation of diverse and complex anti-deferral regimes for investors adds complexity and costs to investors. We would welcome an approach that could serve to harmonise all such anti-deferral regimes. This would have the double benefit of protecting against tax deferral for contracting parties to a tax treaty, and greater simplicity for investors in funds.

Question 21. As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

We believe it is reasonable to require the claimant (ie the fund) to satisfy itself of the validity of its claim, and that it should take reasonable steps to ensure the reasonableness of claims of equivalent beneficiary status from investors.

In order to ensure the operability of this rule, it would be necessary for the Commentary to include examples of how a non-CIV may satisfy themselves of this status. For example, in many (but not all) cases, a self-certification obtained for CRS purposes will have sufficient information to establish treaty eligibility of an investor. Where this is the case, a fund should be able to rely on the CRS self-certification for claiming treaty benefits.
**Question 22.** What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

We are concerned that the revised LOB clause requires a “qualifying intermediate owner” to be resident in a country that has a double tax treaty with the US which includes provisions addressing special tax regimes. This is not always going to be the case given how long it takes for tax treaties to be updated.

**Suggestion that the LOB should not deny benefits to a non-CIV resident of a State with which the non-CIV has a sufficiently substantial connection**

**Question 23.** Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

We do not have any views specifically on this proposal other than to observe that for a range of legal, commercial, governance, tax and practical reasons, we think it is important to preserve the distinction between a fund and its manager.

**Suggestion of a “Global Streamed Fund” regime**

**Question 24.** Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features.

We support the proposal for a Global Streamed Fund. For reasons we have highlighted above and are already noted in the consultation document, there appears to be no comprehensive and absolute solution to the problem of granting treaty benefits to non-CIV funds. This reflects the growing internationalisation of capital markets, which challenges the paradigm of bilateral tax treaties.

The GSF has the significant advantage of shifting the point of taxation to the ultimate investor, which is the goal in structuring any fund vehicle. This not only ensures that the investor gets the right tax treatment in relation to the underlying investments, it also removes the need for the fund itself to enter into financial arrangements (such as the use of debt finance through entities in a fund vehicle) that are designed to achieve the same result of shifting tax to the ultimate investors.

We strongly support further work on a comprehensive solution to treaty access (and more generally the taxation of funds) and we believe that the GSF is a model to work towards. We accept that there are significant challenges to a GSF model, particularly the need to devote significant resources to achieving consensus amongst OECD members on such a model.

It may be necessary to consider interim solutions in the meantime (such as derivative benefits and proportional treaty benefits), but only a comprehensive solution would bring the global framework supported by the MTC up to speed with the globalisation of capital markets.
In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?

We believe the approach would need to be accompanied by agreements on effective anti-deferral mechanisms, as highlighted in our response to Question 20. So income distribution is not required to the extent that investors are required to recognise income in the fund on a current basis.

- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?

Yes. We believe that this approach could only work alongside a regime for documentation of investors - particularly one that builds on CRS documentation requirements. However, as we mention above, we believe there is a growing acceptance that information on ultimate beneficiaries can be obtained in order to provide better treaty access for ultimate investors in funds.

**Concerns related to the PPT rule**

**Question 25.** Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

We believe that example D in the Commentary to the PPT in the final BEPS 6 report should apply equally to CIVs and non-CIV funds. We are concerned that without the clarification non-CIV funds might be presumed to breach a PPT condition in exactly the same circumstances. In applying the example to non-CIVs we believe it would be necessary to exclude the wording “manages a diversified portfolio of investment in the international financial markets”. Although many non-CIV funds will do that, it will not be the case for some non-CIVs, and it has not impact on determining whether a principal purpose of the fund is obtaining treaty benefits.
22 April 2016

Dear Madam/Sir,

Re: Public Consultation on Treaty Entitlement of Non-CIV Funds

We are writing to you in response to your public discussion draft on the treaty entitlement of non-CIV funds dated 24 March 2016 (the “Discussion Document”).

The Irish Funds Industry Association (“Irish Funds”) is the representative body of the international investment funds community in Ireland, representing the administrators, depositaries, managers, transfer agents, fund promoters and professional advisory firms involved in the international fund services industry in Ireland. Ireland is a leading centre for the domiciling and administration of collective investment vehicles, with industry companies providing services to collective investment vehicles with assets totalling in excess of €3.8 trillion.

Irish Funds acknowledges the good work that has been done to date in respect of Action 6 of the OECD’s Base Erosion and Profit Shifting project (“BEPS”), and welcomes the opportunity to discuss its application to non-CIV funds in more detail.

1 General comments

1.1 Economic importance of non-CIVs

We agree with the OECD that non-CIV funds are economically important to the global economy and that non-CIV funds should therefore be granted treaty benefits in appropriate cases. The development of cross-border investment in the ‘real’ economy, i.e. in infrastructure, technology, sustainable energy and unlisted companies, is a policy objective of the EU’s Capital Markets Union (“CMU”) initiative and similarly, of the OECD and governments globally. Non-CIV funds are typically deployed for such investments, as restrictions often relating to CIV type funds would prevent them investing in such asset classes (e.g. eligible asset restrictions, diversification requirements, liquidity etc.).
In this regard, it is critical that the important role non-CIV funds play in the real economy is recognised. With net assets totalling €452 billion, Irish regulated cross-border AIFs are a key feature of this important investment landscape and the treaty entitlement of regulated non-CIV funds is a key issue for globally distributed, regulated investment funds. We appreciate the concerns raised in respect of the treaty entitlements of non-CIVs and are eager to ensure that non-CIVs are not used inappropriately for the purposes of treaty shopping.

1.2 Background on Irish collective investment schemes

By way of background, our responses to the questions are answered in the context of regulated funds. Irish collective investment schemes are subject to EU and local regulation with a focus on governance, organisational and operational arrangements, product specific requirements, transparency and investor protection. Irish collective investment schemes, established as either UCITS or AIFs, are authorised and subject to ongoing supervision by the Central Bank of Ireland. Irish funds are distributed globally in over seventy countries and also invest globally in a diverse range of assets classes. As such, our response is from the perspective of the regulated cross-border funds industry in its role in facilitating important cross border investment.

Irish collective investment schemes operate in a clear, certain and transparent tax environment and are subject to the highest standards of automatic exchange of information under the Common Reporting Standard and FATCA.

1.3 Opportunity for further engagement

We note that commentary of the OECD in the Discussion Document does not yet represent a proposed consensus approach nor does it set out proposed steps for dealing with the treaty entitlement of non-CIV funds. We therefore would welcome the opportunity to further engage with the OECD in the context of any emerging consensus or proposals arising from the consultation.

We have the following comments and observations on the Discussion Document.

2 Concerns related to the LOB provision

Treaty access for regulated and/or widely-held non-CIV funds.

Question 1: What would be the threshold for determining that a fund is ‘widely held’ for the purposes of such a proposal?

We believe that it would be very challenging to definitively define what ‘widely held’ means in an investment fund context. Investment funds are established in a wide variety of ways, depending on the circumstances catering for different types of investors and often involving different types of feeder funds and intermediaries for various commercial reasons. We believe that the absence of a description of this term in the 2010 OECD report on the granting of treaty benefits with respect to the income of collective investment vehicles (the “2010 Report”) was intentional, and reflected the challenges that would be involved in determining and agreeing what ‘widely held’ means.

In any exercise to determine a threshold for the term ‘widely held’, it would be important to recognise that non-CIV funds may be indirectly widely-held. For example:
a) A non-CIV may have one direct investor, holding 100% of the units in that non-CIV. However, that single direct investor may be acting as a feeder fund for a large number of unconnected third party investors. If that feeder fund is ‘widely held’, then the underlying non-CIV should also be treated as ‘widely held’, even though it only has one single direct investor.

b) A non-CIV may have one direct investor, but that investor may itself have characteristics that result in the non-CIV being ‘widely-held’. In particular, if that single direct investor was a pension fund, which had a large number of unconnected beneficiaries, then the non-CIV should be treated as ‘widely held’, even though it only has one direct investor.

In addition, it would be important to recognise the position of non-CIVs where they have launched and are in a growth phase. We believe that it would not be appropriate to penalise such non-CIVs simply by reason of any predetermined threshold not being met.

To the extent that it is decided to provide more description on what ‘widely-held’ means, we believe that it may be more fruitful to approach this from the other perspective, and describe funds which it is agreed are not ‘widely held’. This may be more in keeping with the true intention of the 2010 Report.

**Question 2:** What types of regulatory frameworks would be acceptable in order to conclude that a fund is ‘regulated’ for the purposes of such a proposal? For instance, would these include the types of regulatory requirements in paragraph 16 of the 2010 CIV report (ie, “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g., “know your customer” rules)?

We would note that the regulatory requirements listed in paragraph 12 of the 2010 Report are simply examples of regulatory restrictions that may be imposed on regulated funds. They are not essential or prerequisite restrictions to which a CIV must be subject before it can be considered to be sufficiently ‘regulated’ for these purposes. This is clear from the preamble of the sentence, which commences “Typically, there will be …” (our emphasis). This is also clear from the earlier definition of CIV in the 2010 Report as a fund which is “subject to investor-protection regulation”, which is notably a broader description.

In our view, if being ‘regulated’ or ‘subject to investor-protection regulation’ is a condition to more favourable treatment under an LOB, non-CIV funds should not have a higher regulatory threshold than CIV funds to access treaty benefits. If a particular regulatory regime meets the agreed threshold for CIV funds, it should equally meet any such threshold for non-CIV funds.

In addition, given that non-CIVs invest in a wider range of assets, the regulatory framework imposed on non-CIVs is typically different to that imposed on CIVs. We believe that certain of the following regulatory characteristics are typically seen in regulated non-CIVs. These should be considered if it is felt that it is necessary to list relevant characteristics:

- requirement for assets to be entrusted to a single, independent, regulated depositary, custodian or trustee;
requirement for the investment manager to be a regulated investment manager;
requirement for an independent regulated administrator;
requirements on full disclosure to investors of investment policy, risks and conditions;
requirement for fair treatment of all investors in the non-CIV;
restrictions on related party investments;
rules on valuation of the non-CIV's assets; and
approval of board members of the non-CIV by the regulator of the non-CIV.

Finally, we would note that many regulated non-CIVs will also have, in the normal course, feeder funds through which investors make their investment, and these feeder funds may not themselves be regulated funds.

**Question 3:** Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

If a non-CIV is both widely-held and regulated, then the only difference between it and a CIV (in line with the description of CIVs in the 2010 Report) is the type of assets in which it invests. A CIV must invest in a 'diversified portfolio of securities', whereas a non-CIV in this context would be investing in another asset class (e.g. commodities, infrastructure).

We do not see any reason why the type of assets held by a fund should influence whether it is entitled to treaty access or not. For example, it should not matter for treaty access whether a fund invests in stocks and shares or, alternatively, commodities. The policy rationale for granting treaty access should be the same either way.

The 2010 Report agrees that a CIV should be entitled to treaty access. In our view, a non-CIV which is both widely-held and regulated (and only fails to qualify as a CIV because it invests in assets which are not 'securities') should equally be entitled to treaty access on its own merits. It is difficult to see any policy justification to deny treaty benefits to such non-CIVs.

While appreciating that this treaty-shopping concern has arisen, we believe that an explanation of how widely-held, regulated funds operate and the regulations and transparency requirements to which they are subject should properly address this concern. In particular, we disagree with the contention that it is 'relatively easy' for a widely-held, regulated fund to be used for treaty shopping. The fact that the fund is widely-held (and managed by a regulated investment manager and subject to a comprehensive regulatory regime) is strong evidence that the fund has not been established for a treaty shopping purpose. In addition, it is important to note that there are many reasons why investors may choose to invest in non-CIV funds, including:

- the improved security for their investment, provided by a regulated fund regime;
• reduced investment costs by reason of collective investment;
• access to expertise in investment portfolio management; and
• ongoing oversight of investments.

These are the main reasons for investing in regulated non-CIVs. For this reason, we would respond that a non-CIV which is both widely-held and regulated should be treated in the same way as a CIV in the application of the LOB.

The treaty-shopping concerns are addressed because the fund is ‘widely held and regulated’. Such funds are established for normal commercial reasons, and not to ‘shop’ for a favourable tax treaty, as was accepted to be the correct position by the 2010 Report.

**Question 4: Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for a proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?**

In our view, a mandatory distribution requirement should not be imposed as a condition of any treaty access. No such distribution requirement is proposed for CIVs, even though they also can result in the ‘deferral of tax’ for investors in CIVs which do not regularly make distributions. As the context of this question deals with non-CIVs which are regulated and widely-held, we do not see any policy rationale for requiring widely-held, regulated non-CIVs to make periodic distributions, when it is agreed that CIVs are not expected to do similar.

Additionally, our experience is that the question of whether a fund will be established on the basis that it will make periodic distributions is driven by commercial considerations, and not tax considerations. We would also note that there can sometimes be restrictions on distributions imposed by law, if the relevant entities do not have sufficient reserves to legally pay the distributions.

Therefore, for widely-held, regulated non-CIVs, we do not believe that there would be real concerns shared by a majority of member states about deferral of tax. Widely-held, regulated non-CIVs are established for bona fide commercial reasons, and not for the avoidance (or deferral) of tax. This was accepted by the 2010 Report in the context of analysis of CIVs, and should equally be accepted here.

**Question 5: States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?**

Publicly-listed companies are entitled to treaty access under an LOB provided, broadly, their shares are sufficiently “regularly traded” on a recognised stock exchange in their country of residence (or other specified exchange, subject to further conditions).
The “regularly traded” condition for publicly-listed companies is the equivalent of the “widely held” condition for funds. Indeed, the 2015 Final Report on Action 6 (the “2015 Report”) explains the special treatment of publicly-listed companies by stating that “shares of publicly traded companies … are generally widely-held … [and] are unlikely to be established for treaty shopping” (our emphasis).

For the same reason, regulated funds which are widely-held are equally unlikely to be established for treaty shopping. In other words, the widely-held nature of both these types of entities makes them justifiably entitled to different treatment under the LOB (when compared with normal companies and corporations).

Therefore, we believe there are strong policy reasons for granting an exception to widely-held, regulated investment funds - whether CIVs or non-CIVs - which is equivalent to that granted to publicly-listed companies. We would suggest that it is difficult to see a policy reason to reach a different conclusion.

Question 6: One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

There are no typical approaches to ‘investing through intermediaries’. The majority of regulated non-CIVs, in our experience, make their investments directly (and not through intermediaries). When investments are made through intermediaries, the approach taken will depend on the asset class involved. For example, where non-CIVs make investments in real estate, it can be the case that such investments are made through wholly-owned subsidiary companies established in the State of source.

We would note that the use of intermediaries for holding assets is typically driven by commercial concerns, rather than tax. The nature of the assets in question (e.g. real estate, infrastructure, energy) means that there are commercial factors such as senior debt/project finance, minority owners or co-owners, contractual relationships with customers/tenants/suppliers etc. Some or all of these factors will generally trigger a requirement for intermediate holding companies to hold all or part of the assets of the non-CIV.

Non-CIV funds set up as transparent entities

Question 7: Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

The new transparent entity provision will be, we believe, an important tool to ensure that source countries correctly recognise the tax transparency of fiscally transparent entities, and grant treaty
entitlements by reference to the tax treaty between the investors’ countries of residence and the source country.

In addition, we believe that the implementation of TRACE, or a workable alternative, remains very important to the successful granting of treaty benefits to tax-transparent non-CIVs. This is particularly so for widely-held fiscally transparent CIVs and non-CIVs. In the absence of a full global implementation of TRACE, there will always and inevitably be large segments of tax-transparent CIVs and non-CIVs which will find it challenging to claim treaty benefits on behalf of their investors.

Derivative benefit rule applicable to certain non-CIV funds

**Question 8:** The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty shopping and, if yes, why?

In our view, this example supports the inclusion of a derivative benefits clause which caters for funds in the LOB, and is an important example to show why such a derivative benefits clause is necessary to ensure treaty access is not unfairly denied.

However, we would not support the restriction of any such derivative benefits clause to ‘institutional investors’. In our view, the rationale for a derivative benefits clause is a good one, irrespective of the commercial/regulatory/financial status of the investors.

Whilst we believe it would be very challenging to define an exhaustive list of all types of ‘institutional investor’, we believe it would include at the very least banks, other regulated funds, pension funds, insurance companies, charitable endowments, sovereign wealth funds and governments. However, we would note that, where those institutional investors make their investments through intermediate entities, the identification of the ‘institutional investors’ becomes more challenging.

**Question 9:** Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

We believe there may be a simple way to deal with this definitional issue.

The proposed derivative benefits rule should be included in the LOB, because the ‘seven or fewer’ test in the main derivative benefits rule will not work for non-CIVs (which will typically have much more than seven investors). We would also note, in passing, that in the context of investment funds the focus on a small number (seven or fewer investors) runs contrary to investment funds being ‘widely-held’ in the first place.

However, we can see no reason why this additional derivative benefits rule should not be applicable to all companies (and other persons that are not individuals, such as unit trusts). In other words, any
company – whether a collective investment vehicle or not – should be able to benefit from its terms. If an 80% equivalent beneficiary threshold is imposed, what concerns could member states have, if a company that was not an investment fund nevertheless satisfied the factual conditions imposed by the rule and sought to claim treaty benefits as a result?

This approach would mean that there would be no requirement to define what is a ‘non-CIV’. We believe there is much merit in adopting this approach.

**Question 10:** Paragraph 17 above refers to the possible inclusion of “specific anti-avoidance rules”. What would these rules be?

We would not support the inclusion of any specific anti-avoidance rules.

The whole rationale for employing an LOB to prevent treaty shopping is that it provides a clear test for determining treaty access, and thus provides certainty for taxpayers. Whilst an LOB can deny treaty benefits to persons who arguably should not be denied, the quid pro quo is that – where the LOB is satisfied – treaty access should generally be guaranteed (subject to satisfying the OECD-approved domestic anti-conduit rules).

There are no such ‘anti-avoidance’ rules proposed for the standard clause (e) of the LOB (ownership / base erosion). It must be remembered that clause (e) will permit treaty access even where 49% of the shares of the company are held by persons who are not entitled to similar or better treaty benefits. If no anti-avoidance rule is considered justifiable in such instance, we do not see the rationale for imposing such anti-avoidance rules for this derivative benefits rule.

**Question 11:** What would constitute a ‘bona fide investment objective’ for the purpose of paragraph 17 above?

We would not support the introduction of this condition. We believe that a derivative benefits rule for non-CIV funds should operate without this condition. This rule should operate, like the remainder of the LOB, as a clear mechanical test and, if no such condition is imposed for clause (e) of the LOB, we do not see a justification for such an imposition under this proposed derivative benefits rule.

That said, we believe that the appointment of a regulated investment manager by a non-CIV would be a good indication of a bona fide investment objective.

**Question 12:** How would it be determined that a fund is ‘marketed to a diverse investor base’ for the purpose of paragraph 17 above?

We would not support the introduction of this condition, for the same reasons as outlined in our response to question 11.

**Question 13:** Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interest in a typical collective investment fund that is widely distributed?

It is not possible to generalise. Some non-CIV funds have very dynamic changes in ownership, especially where they are widely-held and regulated, but are investing in alternative assets. Other non-CIV funds have relatively stable ownership over their life. A material factor which tends to influence this matter is the type of assets in the non-CIV. For example, a non-CIV which invests in...
frequently traded commodities tends to be more liquid in its investment assets, and may have a more dynamic change in its investor base. In contrast, a non-CIV making long-term investments in infrastructural assets should tend to have a more stable investor base. This is no different to CIV funds which are closed-ended in nature, and as a result tend to have stable and static ownership over their life.

**Question 14.** How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

We would agree that this proposal does not address such concern. For this reason, we believe that widely-held, regulated non-CIVs should be treated in the same way as CIVs for the purposes of the LOB, so that they could obtain treaty access in their own name. Our answer to question 3 above sets out our case in this regard.

For non-CIVs that are not widely held and regulated, and may need to rely on a derivative benefits rule, there is a challenge in determining the identity of the ultimate beneficial owners. TRACE would offer the best solution. In the absence of full implementation of TRACE, it may be possible to operate an adapted version of TRACE, using self-certification by investors through intermediaries, to the non-CIV to offer a practical mechanism for the collection (and submission) of the relevant information. A self-certification approach has been successfully implemented in recent years by FATCA, and by the OECD in respect of the Common Reporting Standard.

**Question 15:** What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example, under anti-money laundering, FATCA or common reporting standard rules)?

It varies, depending on a non-CIV’s ownership structure. In some cases, the managers and administrators of non-CIV funds will have full knowledge of the ultimate beneficial owners. This is especially the case where such owners invest directly in the non-CIV. However, in other cases, the managers and administrators will have no information at all regarding the ultimate beneficial owners. In particular, where such investors make their investment through a financial institution (e.g., a bank or stock broker), the non-CIV (and its manager and administrator) will only have to look to that financial institution named on the share register when carrying out their AML, FATCA and CRS due diligence procedures. There are clear rules under AML, FATCA and CRS in this regard, setting out the circumstances when a non-CIV is required to look only to the financial institution recorded in the share register of the non-CIV as the holder of the shares. As a result, in many cases, the non-CIV is not required (for AML, FATCA or CRS) to look beyond such intermediary, and does not have any legal entitlement or authority to do so. Of course, that intermediary will generally have its own AML, FATCA and CRS due diligence procedures to carry out on the persons for whom it holds the units in the non-CIV.

**Question 16:** Is this information currently sufficient for the relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlements of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that
suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

Yes, intermediate ownership does present real obstacles to obtaining the relevant information. In our view, TRACE offers the best solution to this issue.

However, we would reiterate our view that widely-held, regulated non-CIVs should be entitled to treaty benefits in their own right.

For other non-CIVs, and in the absence of full implementation of TRACE, it may be possible to introduce an adapted version – through a self-certification model – under which investors confirm their status to the intermediary with whom they deal, and this information is passed to the non-CIV, similar to the approach adopted and accepted for FATCA and CRS purposes and US treaty entitlement forms such as the W-8BEN form.

Question 17: Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits.

We disagree with the statement that typical CIVs do not tend to have chains of intermediaries. In our experience, a sizeable proportion of CIVs do have chains of intermediaries. These intermediaries are generally financial institutions, such as banks and stock brokers, who hold the units in the CIVs on behalf of the ultimate beneficial owner. In this regard, we would refer to the 2010 Report where it is stated that “in almost all markets, direct purchases (and holdings) are a small proportion of the investments in the CIV. Much more common are indirect share purchases through one or more intermediaries.”

However, we agree that for many non-CIV funds it will be challenging in the current administrative environment to obtain the necessary investor confirmations. In the absence of full implementation of TRACE, we would propose that an adapted self-certification model, as described in our response to question 6 may be a suitable approach for non-CIVs that are not widely held and regulated.

Question 18: The proposal would grant treaty benefits if a certain high percentage of a non-CIV fund is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty shopping as a 20% participation in a very large fund could represent significant investment. How could this concern be addressed?

A company seeking to satisfy the LOB under clause (e) (ownership / base erosion) will satisfy the LOB even if investors not entitled to similar or better benefits hold a 49% participation of its shares. If such a 49% participation is acceptable for a company in normal cases, we believe there should be no concern over granting a 20% participation threshold for non-CIVs under the derivative benefits test. Such non-CIVs are clearly not established for treaty shopping purposes. Put another way, the
80% of the investors in that non-CIV are not making their investment to facilitate treaty-shopping by a small minority of investors.

**Question 19:** One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

If a 50% base erosion test is acceptable for all other types of companies under the LOB, we cannot see any policy justification for imposing a higher threshold for non-CIVs. Put another way, before applying a base erosion test:

- under this derivative benefits proposal, a non-CIV would be granted treaty access if 80% of its investors were entitled to similar or better treaty benefits; and
- under the normal clause (e) test (ownership / base erosion), a company would be granted treaty access if 50% of its investors were entitled to similar treaty benefits (by being resident in the same country as the company itself).

The starting point is therefore that non-CIVs must have a significantly higher threshold of ‘equivalent beneficiaries’ to reach, and therefore the ‘room for treaty shopping’ (to use the OECD phrase) is already substantially less than for a normal company.

Therefore, we cannot see a logical rationale for imposing a higher base erosion threshold on non-CIVs than for normal companies. Such a move would only further tilt the environment unjustly against non-CIVs.

**Question 20:** According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered to be an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual returns? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

We disagree with the contention that deferral concerns should result in a denial of treaty benefits for investment funds, whether non-CIVs or otherwise. We believe this may be a misguided concern, and fails to appreciate the nature of financial investment.

Firstly, the 2010 Report accepts that CIVs should be entitled to treaty benefits even if there is some deferral of the taxation of the profits in the hands of the investors in the CIV. This reflects the nature of investment funds, that they do typically accumulate investment returns for a period of time, before making distributions to investors. The reinvestment of profits is an intrinsic part of collective investment, and there are good commercial reasons why investment funds carry on their business in this way. Investors and, in particular, pension fund investors frequently seek out funds that do not distribute their profits each year, but instead reinvest their profits in fresh investments. This allows investors to make their investment decisions in line with their long term financial needs and
timelines. In our experience, CIVs and regulated non-CIVs are not set-up for the purpose of achieving ‘tax deferral’. They are instead set-up to achieve commercial objectives such as long term investment. The denial of treaty benefits in circumstances where investors are simply making bona fide commercial decisions to make long term investments would be a wholly disproportionate response to an issue which is in no way a driver or factor in the investment decisions made.

Second, aside from investment funds, tax treaties have never imposed an anti-deferral test for granting treaty benefits. Companies (aside from investment funds) are generally entitled to treaty benefits, even if they will not be actually subject to tax on the item of income because of their specific circumstances, such as the availability of tax losses or tax depreciation, or a specific tax exemption under local law. This general principle has been accepted over the decades without question, and we believe that it should not be diluted in the context of investment funds (whether non-CIVs or otherwise) through the introduction of an anti-deferral regime.

Third, we would note that, even where there is a deferral of the return of profits to investors, the profits are always returned to investors in due course. In the current context of a derivative benefits clause, it will have been confirmed that the investors will be resident in countries with equivalent tax treaties, so the State of source should have comfort that the income in question will be appropriately taxed.

Fourth, any concern about deferral must also be tempered by the acknowledgement that investors are wholly open to making losses on their investments through the non-CIV. Investors must also suffer ‘deferral’ of their recognition of any losses as a natural result of the way investment funds operate. Investors accept this consequence of their investment decision.

Fifth, we would note that there are other OECD BEPS action items to address perceived abuses of ‘hybrid mismatches’ and non-taxation of income. We would submit that such action items are better placed to address any concerns from member states in this area.

Finally, countries may of course decide to introduce anti-deferral rules for their residents on a domestic basis. Many jurisdictions have indeed adopted rules in this regard for their residents, including Ireland. Many jurisdictions also impose a higher taxation regime for investment funds which provide for deferral. In other words, if investors are not taxed on a current basis on their investment in an investment fund, the investor is taxed at a higher rate when it earns its return from that investment fund.

**Question 22:** The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derive benefit provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016. Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the ‘seven of fewer’ condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?
The US model treaty provision is problematic in that it should apply to any ‘person other than an individual’, and not just to ‘companies’. This is required to reflect the fact that many non-CIV funds are constituted in a legal form which is not a ‘company’, such as a unit trust.

**Question 24:** Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
- What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

The proposal for a Global Streamed Fund regime is innovative, and deserves further review and consideration. At the core of the proposal would be the elimination of withholding tax at source and the remittance of taxes from the State of residence to the State of source. We believe that it should be possible to facilitate this, as it has been achieved before within the EU Savings Tax regime (albeit on a regional basis).

We would agree, though, that the GSF proposal raises challenges for non-CIV funds that do not distribute all their income on a current basis, and for non-CIV funds that cannot determine who their investors are. Operationally, the GSF proposal could be challenging to apply in practice, so any further consideration of the proposal would need to be mindful of the application on a day-to-day basis.

As a general principle, we strongly believe that tax rules should not be the key driver for the investment policy and strategy of an investment fund. If an investment fund wishes to make long-term investments, and roll-up any periodic returns into further re-investment, then the investment fund should be facilitated to do so. The global economy badly needs investors who make long-term investments, and investment funds (in particular, non-CIV funds) are one of the key investor classes now willing to make such long-term investments. Given this economic fact, we do not believe that tax rules should then effectively force those same investment funds to distribute their income on a current basis, thus imposing a short-term distribution policy on an investment fund looking to make a long-term investment.

For this reason, if the GSF proposal were to be adopted, it would need to be elective in nature. If a non-CIV fund wished to operate under the GSF regime, it should be able to elect to do so. However,
if a non-CIV fund does not so wish, then such non-CIV must remain entitled to fall outside the GSF regime. This may arise because of either:

- the non-CIV is making a long-term, rolled-up investment, and its investment strategy does not involve the making of distributions on a current basis; or
- the non-CIV is widely-held with a dynamic change in ownership, in which case the non-CIV may not be able to determine the identity of the investors;

If a non-CIV did not elect to fall within the GSF regime, the non-CIV fund should be treated in line with the main principles of the LOB.

Due to the nature of the proposed regime, it would also require coherent changes in the domestic laws in the State of source to forego source taxation, the country of domicile of the fund (electing to fall within the GSF regime) to withhold foreign taxes and clear rules allowing and indemnifying the fund on application of withholding tax on the basis of an investors attestation in respect of its treaty entitlements between the investors country of residence and the source country. In addition, there is likely to be requirement for bi-lateral or multi-lateral agreements between impacted countries providing for the collection and remittance of the withholding tax and audit/compliance procedures. As a result, the proposed GSF regime would require some fundamental legal infrastructure developments. This, in turn, would require a significant commitment from a broad base of countries to make this a viable option. In our view, these commitments in principle by countries should be given before the GSF regime becomes a practical and viable option.

3 Concerns related to the PPT rule

We believe that relevant and practical examples are crucial to the proper operation of the PPT rule. Given the range of approaches adopted by investment funds, it is important to have more than the single example currently included. We are available to meet with the OECD to discuss the practical scenarios for investment funds and suitable examples which could be included in the Commentary, and would be very happy to do so if that was found to be helpful.

At this stage, we would suggest the following examples be included in the Commentary:

**Widely-held, regulated investment fund with two share classes**

Note: in this example, underlined text is that which is different to the example for investment funds already in the Commentary.

*RCo, a collective investment vehicle resident in State R, manages a diversified portfolio of investment assets, including assets which are not securities. RCo is subject to investor protection regulation in State R. The shares in RCo are widely-held. RCo has two classes of shares: the first class of shares are ‘distributing’ shares which give investors the right to annual distributions of income from RCo, and the second class of shares are non-distributing shares where RCo reinvests any income arising into further investment assets. A majority of investors holding shares in RCo are not residents of State R, and a number of these investors (a minority) are residents of States with which State S does not have a tax convention.*
RCo currently holds 15% of its portfolio in shares of companies resident in State S, in respect of which it receives annual dividends. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30% to 10%.

RCo’s investment decisions take into account the existence of tax benefits provided under State R’s extensive tax convention network. Investors’ decisions to invest in RCo are not driven by any particular investment made by RCo and RCo’s investment strategy is not driven by the tax position of the investors.

In making its decision to invest in shares of companies resident in State S, RCo considered the existence of a benefit under the State R / State S tax convention with respect to dividends, but this alone would not be sufficient to trigger the application of paragraph 7. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, unless RCo’s investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R / State S tax convention to RCo.

**Widely-held, regulated investment fund with feeder funds**

Note: in this example, underlined text is that which is different to the example immediately above for a ‘Widely-held, regulated investment fund with two share classes’ example.

RCo, a collective investment vehicle resident in State R, manages a diversified portfolio of investment assets, including assets which are not securities. RCo is subject to investor protection regulation in State R. RCo is a ‘master fund’, and its shares are held by two ‘feeder’ funds. The shares in the two feeder funds are widely-held. RCo has two classes of shares; the first class of shares are ‘distributing’ shares which give investors the right to annual distributions of income from RCo, and the second class of shares are non-distributing shares where RCo reinvests any income arising into further investment assets. Investors in the feeder funds invest in matching share classes, so that the income paid on the ‘distributing’ shares by RCo to the feeder funds is on-paid by the feeder fund to the investors without deferral. A majority of investors holding shares in the feeder funds of RCo are not residents of State R, and a number of these investors (a minority) are residents of States with which State S does not have a tax convention.

RCo currently holds 15% of its portfolio in shares of companies resident in State S, in respect of which it receives annual dividends. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30% to 10%.

RCo’s investment decisions take into account the existence of tax benefits provided under State R’s extensive tax convention network. Investors’ decisions to invest in RCo are not driven by any particular investment made by RCo and RCo’s investment strategy is not driven by the tax position of the investors.

In making its decision to invest in shares of companies resident in State S, RCo considered the existence of a benefit under the State R / State S tax convention with respect to dividends, but this alone would not be sufficient to trigger the application of paragraph 7. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not
paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, unless RCo’s investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R / State S tax convention to RCo.

Yours sincerely,

Pat Lardner

Chief Executive
22 April 2016

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Consultation Paper

Dear Sirs

Base Erosion and Profit Shifting: Treaty Entitlement of Non-CIV Funds.

Introduction

We refer to the OECD’s Public Discussion Draft on the Treaty Entitlement of Non-CIV Funds and have provided comments on behalf of the Jersey Funds Association in respect of the specific questions raised within the Discussion Draft.

We have also included in this note a summary of what we believe to be key overriding matters for consideration which may not otherwise be addressed within our responses to the specific questions.

Jersey Funds Association (the JFA) represents Jersey’s well established and growing funds industry. It works with the funds industry, policymakers, regulators and legislators to promote the highest standards of professional conduct amongst funds organisations. The JFA encourages cooperation between its members and provides a forum for discussion and exchange of ideas on matters in which its members share a mutual interest, as well as a medium through which its members may express professional opinions of public matters.

The JFA currently has approximately 100 members. Our member base includes fund managers, administrators and depositaries, as well as institutional investors, fund of funds managers, and advisors representing all facets of Jersey’s funds industry. Our fund manager members manage investment funds covering a cross section of asset classes, comprising assets, and representing investors, based across a range of jurisdictions, representing Jersey’s global standing as a centre for funds.
Jersey’s International Standing

Jersey is a recognised leader in global regulation and co-operation as assessed by international bodies including the IMF, IOSCO, MONEYVAL, ESMA and the OECD.

Jersey is fully aligned with the highest standards of the EU Anti-Money Laundering Directive and was one of the first international finance centres to become a full signatory to the IOSCO Multilateral Treaty, an international benchmark for cross border co-operation between regulators. Jersey was also an early adopter of the Common Reporting Standard, the global standard in Automatic Exchange of Information.

Jersey's world class reputation is continually strengthened by its on-going commitment to comply with international standards, regulation and transparency in certain finance centres. The Jersey authorities are fully committed to transparency and the exchange of information for tax purposes and Jersey's practices demonstrate a responsive and co-operative approach in these areas.

In an increasingly global world, there is growing demand for secure and efficient multinational transactions. Jersey offers tax neutrality to investors which means individuals and companies who are conducting business globally can pool investments from multiple economies to finance projects globally efficiently and cost-effectively. Jersey’s robust legal framework and sound judiciary offer protection to investors who might be uncomfortable investing directly into riskier countries.

Through its strong links with London and other major cities, Jersey has deep access to capital markets for investment in infrastructure, telecommunications networks, machinery, buildings, homes and other physical capital to foster jobs and growth.

Jersey is an important conduit for Foreign Direct Investment to the EU – for example, the 2013 Jersey’s Value to Britain research found that Jersey is a conduit for nearly £0.5 trillion (€0.64 trillion) of foreign investment into the UK, comprising 5% of the entire stock of foreign owned assets (as at 2011), vividly highlighting Jersey’s role as an investment gateway to Europe (source - Capital Economics research – Jersey’s Value to Britain, 2013). Jersey is recognised by investors as having a significant depth and breadth of professional expertise which has been developed for over 50 years. Jersey has a stable political and economic environment with an established infrastructure designed to support the needs of the investment management industry. International organisations with a presence in Jersey include BNP Paribas, Deutsche Bank, JP Morgan Chase, Citibank, Standard Bank, Royal Bank of Canada, State Street, UBS, and SG Hambros.

Points on the consultation

The JFA represents participants and structures which have a primary purpose of the co-investment or pooling of capital for the purposes of investment. The JFA is highly supportive of improvements in regimes that would allow international investors better and more consistent regimes. Appropriate entitlement to treaty benefits will play an important role in implementing these improvements.

We understand that collective investment vehicles (CIVs) will be entitled to treaty benefits and are keen to assist the Working Party in ensuring the new treaty provisions adequately address the treaty entitlement of other non-CIV funds. Non-CIV funds are a means of savings and investment which are key contributors to a healthy global economy and it is fundamental that treaty benefits are granted where appropriate to ensure that the economic importance of non-CIV funds is recognised.
Key Overriding Issues for Consideration

At a general level the JFA's key comments are as follows:-

1. It is helpful to focus on the broader picture of what the benefits are of the non-CIV industry. Paragraph 14 of the Report on Action 6 recognizes the economic importance of non-CIVs, and that there is a "need to ensure that treaty benefits be granted where appropriate". We share the view that all the asset classes represented across our industry benefit both investors and investee businesses by encouraging structures which are established and regulated in a fiscally neutral environment with stable legal and regulatory features, which enables the delivery of pooled investment products in a non-discriminatory manner.

2. We note the focus on an analysis of funds which are widely held and/or regulated, being two of the three tests of a CIV i.e. a retail type fund (which has been used in earlier BEPs related reports).

3. While we acknowledge that many non-CIVs may share these characteristics, it must equally be recognised other non-CIVs will not – i.e. they will tend to be less widely held and (partly as a corollary) they will often be lightly regulated private non-CIV funds with "professional investor" type regimes. Therefore, as part of this exercise we would also advocate focussing on other aspects of the regulatory environment relating to non-CIV funds. In particular, in the case of private funds in Jersey which may have small numbers of investors (but which may nonetheless be economically very significant), these will still have the advantage of a highly regulated service provider and exacting KYC/AML and tax reporting requirements. These non-CIV funds will typically have a stable, easily identifiable and long term investor base providing greater ease in being able to record and monitor high quality information as to the identity of investors. We believe that, in this scenario, an alternative, effective means of demonstrating fitness for treaty access would be on a basis of investor eligibility.

4. At the same time, we also think that the definition of a CIV which we note is derived from the OECD's 2010 paper, could be further considered. In our view, a number of Jersey funds, particularly OCIF/open ended retail type funds, should in practice be captured by the CIV definition. The non-CIV funds definition should be focussed on professional investor type funds.

5. It would also be helpful to have a more full debate on areas such as, for example, deferral. While many funds would have a strong commercial imperative to deliver returns to reduce cash drag, it is unrealistic to consider that all funds should share this strategy and it is likely that there may be "good deferral" as well as "bad deferral" which should be recognised.

6. We believe that short and long term approaches will need to be considered separately. In the short term the priority should be given to fully articulating and understanding the benefits of non-CIV funds for the global economy, and providing mechanisms for non-CIV fund structures to achieve treaty benefit entitlements, providing these structures fully comply with international regulatory, reporting and transparency standards. The consultation at times appears to presuppose that the motive for using fund structures is primarily for tax advantage benefits. The JFA believes that to presuppose a presumption on wrongdoing risks overlooking the principle commercial rationale for these structures.

7. In the longer term the JFA believes that there is an opportunity to shape a global set of regimes based on the advantages of transparency. Historically the primary driver for using a jurisdiction such as Jersey has been to achieve tax neutrality in order to achieve commercially effective investment and return. To the extent that these features are combined with effective systems for administration and reporting as to identity and tax position of investors, then this would provide a particularly strong imperative for achieving the end goals.
of the asset management industry, which may be combined with the advantages of a simpler overall structure.

8. However there would be work to be done in order to develop a workable set of regimes. We believe that elements of the "global streamed fund" concept could be helpful in this regard, however as currently framed this appears to be limited to a specific set of circumstances which would be more applicable to a CIV structure. We believe that the principle of administering elements of self-certification by investors could provide practical solutions for administrators and would be particularly workable for illiquid long term structures, from private equity to real estate to debt to infrastructure.

9. As a general point, it is noted that a large part of the consultation has been framed around how a limitation of benefits (LOB) provision will work in practice. We note that certain commentators have pointed out that the application of an LOB provision is likely to be restricted to treaty revisions sought by only a limited number of countries. We have, therefore, tried to step back from detailed commentary on the LOB mechanics, and rather to look more generally at the ways that Jersey (and other jurisdiction with significant fund expertise) can deliver workable solutions for non-CIV funds.

**Specific responses to questions.**

1. **What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?**

While it will typically be the case that a non-CIV fund is likely to be less widely held than a CIV, there will still be great variance as to the number of investors, which will depend where the relevant non-CIV fund falls on the spectrum of structures, asset classes and type of investor.

Points to consider:-

- It is likely given that most non-CIVs in Jersey are able to be marketed to and held by a wide number of investors that these would be treated as "widely held" for treaty purposes.

- It would be helpful to treat investors in non-CIV Funds who are themselves widely held as deeming the underlying non-CIV fund to be widely held. For example, private equity or real estate funds with a small number of investors who are institutional and, therefore, representing a greater investor number.

- A number of tax authorities already have tests that could be applied e.g. HMRC tests used in the UK where a "widely held fund" means that either no group of 5 or fewer investors (and connected persons) hold more than a 50% economic interest or that no investors (and connected persons) hold more than a 20% economic interest.

- It should be acknowledged that any such widely held test should be subject to an appropriate start-up period, and wind up period (during which time the test would need to be deemed satisfied).

As a more general point (and as touched in our introductory comments), a number of non-CIV funds in private equity, hedge or real estate areas may not have a widespread investor base, and nevertheless often perform an economically significant role. As an alternative to focussing on the number of investors, it may therefore be valuable particularly for illiquid asset classes (such as private equity, real estate debt and infrastructure) which have a stable and long term investor base, backed up by highly regulated service providers and exacting AML/KYC and tax reporting regimes, to focus instead on the identification of investors in those funds.
2. **What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?**

Any type of regulatory framework being used to determine a non-CIV fund should primarily focus on the quality of the regulator and the level of implementation of international regulatory standards.

- It should be noted that in most jurisdictions (Jersey would be a good example), the level of regulatory control and supervision over any particular non–CIV will tend to be proportional to the number of investors marketed/invested. Therefore to focus on more highly regulated funds will tend to correlate to more widely held funds, which are both badges of CIV funds. In the case of non-CIV funds, while it is acknowledged that the discussion paper considers that widely held/highly regulated might be argued to be evidence of reduced propensity to treaty abuse (although this correlation would not necessarily be the case) it may be more productive to focus on the quality of the regulatory environment.

- Furthermore a very significant proportion of the non-CIV market has been developed in jurisdictions which are international finance centres which are chosen for their regulatory, political and legal stability and their leading practices in the structuring of alternative investment structures (across different asset classes). This has facilitated the most important functions of non-CIV funds, being to allow the international deployment of pooled or co-invested capital into both developed and developing economies.

- Certain regulatory regimes are specifically designed to be applicable and indeed to encourage the establishment of private fund vehicles (as envisaged in the discussion paper with this consultation). These will, by their nature, tend to have less constraints in relation to investment/borrowing restrictions. In these cases, given that private funds by their nature are likely to have less diversity of ownership, it should be helpful to focus on regulatory requirements regarding records/transparency of investor information (see also introductory notes and response number 1 above).

- In some cases (e.g. Jersey) this is combined with a strong track record of engaging transparently with international standards.

- While it is therefore good practice to use regulatory standards from major economies of eg the US and the EU, it would also be highly beneficial, not least in driving regulatory best practice and transparency, that any standard setting of regulatory expectation would also include standards in jurisdictions such as Jersey which have been assessed by international bodies such as the IMF, IOSCO, Moneyval, ESMA and the OECD.

- As part of any such evaluation of standards it would also be appropriate to consider the rules on application of KYC standards in accordance with FATF standards and compliance with FATCA, CDOT and CRS reporting.

3. **Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be**
entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

It would appear highly unusual for a non-CIV which is to be widely held to be designed with a purpose of obtaining treaty benefits. It would be anticipated however that for less widely held structures, a regime based on either fund certification or investor self-certification could be developed in relevant cases (eg where the number of investors is lower or where the fund assets are concentrated in one jurisdiction).

4. **Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?**

Whether or not investors in a non-CIV are taxable only when they receive a distribution would depend on whether the fund would be treated as transparent (for the purposes of tax in the jurisdiction where the investor is resident). To that extent it would be anticipated that investors would include their share of the fund's income on their tax returns as it arises—i.e. on the basis that the fund will report income to investors without any expectation/obligation of distributing it at that point.

In relation to funds which are not treated as transparent, then it may depend on whether an offshore funds-type test is used in the jurisdiction in which the investor is based.

5. **States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?**

A concern would be that a rule which seeks to limit the benefit of tax treaties to persons who are resident in the fund's jurisdiction or "equivalent beneficiaries" will tend to deter investments by non-CIV funds. The JFA would emphasise that the role of non-CIVs which are based in well regulated and transparent jurisdictions is critical in assisting with the growth of a healthy global economy will typically, by its nature, involve multiple jurisdictions, and should be considered separately from publicly traded companies.

6. **One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?**

In relation to all funds (whether non-CIV or CIV) the purpose of tax structuring will be to ensure as far as possible tax neutrality as between a direct investor and a fund investor. Typically any intermediate structure used by a non-CIV fund will be seeking to achieve this overall goal and not for other purposes (particularly in a tax neutral jurisdiction such as
Jersey), although it should be noted that intermediate subsidiaries are in practice used for a range of economic and commercial reasons, which may include e.g.

- Allocation and limitation of risk
- Structuring of co-investment
- Facilitation of reporting
- Facilitation of security, etc

**NON-CIV FUNDS SET UP AS TRANSPARENT ENTITIES**

7. *Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?*

It is understood that in some cases it may be difficult in practice for investors of non-CIV funds to obtain effective benefit of a tax treaty relating to the jurisdiction of the assets sitting below fund level. Possible solutions might be e.g. to regard a transparent non-CIV fund as being a representative of its investors and therefore entitled to make the claims for the benefit of the tax treaties which are applicable to those investors. This should be possible whether or not the transparent non-CIV fund is formed under the laws of the treaty jurisdiction or managed there. Increasing experience of reporting measures such as FATCA, CDOT and CRS would be anticipated to assist with this process over time.

**SUGGESTION THAT THE LOB INCLUDE A DERIVATIVE BENEFIT RULE APPLICABLE TO CERTAIN NON-CIV FUNDS**

8. *The rationale that was given for the above proposal refers to the fact that "investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund". What is the meaning of "institutional investors" in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of "institutional investors", how can it be concluded that institutional investors "are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund"? Also, is it suggested that "institutional investors" are less likely to engage in treaty-shopping and, if yes, why?*

The meaning of institutional investors will depend on definitions used by different regulatory or tax regimes. There is no one definition of this type. Typically institutional investors are pension funds, insurance companies, charitable endowments and other bodies formed in countries with tax treaty networks which afford benefits to them. This may also include sovereign wealth funds or other government agencies which may either qualify for other benefits or enjoy sovereign immunity from tax.

In broader response to this question, it should be noted that the obtaining of tax neutrality is a corollary to their investment and would not be anticipated to be treated as a main purpose of it, and therefore it may be misleading to regard this as "treaty shopping".
9. **Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term "non-CIV" has no established definition. What would be the main types of investment vehicles to which the proposal could apply?**

It is noted that the 2010 OECD report definition of CIVs are defined widely, and that many alternative funds could be treated as being included in the CIV definition, but that e.g. private equity was explicitly excluded from this remit. The definition should be broad enough to include non-CIV funds formed as transparent entities where it may be an opaque entity owned by the non-CIV fund that would be seeking treaty benefits.

10. **Paragraph 17 above refers to the possible inclusion of "specific anti-abuse rules". What would these rules be?**

Specifically anti-abuse rules would address incidences where as a principal purpose a non-CIV fund is used to obtain benefits and treaties which would not otherwise be available. We would anticipate that treaty access could be framed to prohibit the use of non-CIVs for this purpose in conjunction with appropriate consideration of the status of investors through transparency measures and/or self-certification, as applicable.

11. **What would constitute a "bona fide investment objective" for the purpose of paragraph 17 above?**

Bona fide investment objectives would be those which encompass a coherent course of investment by the non-CIV fund and which is not intended wholly or mainly to obtain treaty benefits which would not otherwise be available in the investors made the investment directly.

12. **How would it be determined that a fund is "marketed to a diverse investor base" for the purpose of paragraph 17 above?**

There are a number of tests which could be based on existing regulatory legislation, practice and product types and asset classes which are already used in the market. (E.g. that a fund is intended to be and may be marketed to a diverse investor base with appropriate PPM disclosures and investment restrictions and objectives, in accordance with existing Jersey regulatory regimes).

**Questions related to the identification of the investors in a non-CIV**

13. **Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?**

This will vary significantly between open ended and closed ended funds and different asset classes.

14. **How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?**

It would appear highly unlikely that a non-CIV fund based in a well regulated jurisdiction such as Jersey would be unable to determine who their ultimate beneficial owners are. See response number 2 above.
15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

See response 2 above.

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

The JFA would welcome a more detailed policy discussion around the possibility of self-certification regimes and different methods of obtaining investor information.

Questions related to the prevention of treaty-shopping

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

See above responses in relation to reporting and record keeping of investor information. Most KYC and AML processes in well-established financial centres (such as Jersey) will focus on ultimate beneficial ownership tests and would not be satisfied by looking only at the intermediate entities.

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

We understand many commentators have referred to a general desirability that non-CIVs serve an important role in the global economy – on this basis we would not consider that such structures should be held to a higher standard than general business entities.

19. One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

See response to 18.
Questions related to the prevention of deferral

20. According to the proposal, acceptable ultimate beneficial owners would include persons who would "include their proportionate share of the fund’s income on a current basis". How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

Questions around prevention of deferral should be a question for the tax regime of the country of residence of the ultimate investor. We would refer back to earlier questions on levels of information to be held.

21. As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

No comment – we understand that this will be a question of definitions in a derivative benefits test.

Questions related to the new derivative benefits provision of the United States Model

22. The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016 (see https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-206.pdf , paragraph 4 of Article 22 "Limitation on Benefits"). Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

See responses 1 and 2 above.
SUGGESTION THAT A “SUBSTANTIAL CONNECTION” APPROACH BE ADOPTED

23. Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

We would not attempt to address this in detail. We would consider the priority to be to achieve a clear policy in relation to tax neutral funds being transparently invested in for the purposes for which they were established and regulated.

SUGGESTION OF A “GLOBAL STREAMED FUND” REGIME

24. Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
- What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

We believe that the GSF regime could be attractive for a number of types of non-CIV funds, and should be considered as a medium term proposal, noting that the mechanics/implementation of this structure would need to be carefully considered and consulted on over time. It would not be desirable that this should create an artificial need to create distributions where this is commercially inconsistent with the investment objectives of the fund.

ADDITIONAL EXAMPLES FOR THE COMMENTARY ON THE PPT RULE

25. Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

We believe that previous examples of the PPT rule in practice have been well articulated.

CONCERNS WITH RESPECT TO CONDUIT ARRANGEMENTS

26. Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should
focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

No comment – we believe that previous examples have been articulated.

CONCERNS RELATED TO THE “SPECIAL TAX REGIMES” PROPOSAL

27. Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released in February 2016 (see question 22 above). If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

Any different standard for non-CIVs would need to be explained and articulated.

Yours faithfully

Tim Morgan
Jersey Funds Association
By email only: taxtreaties@oecd.org

22 April 2016

Dear Sir

**BEPS consultation document on the treaty entitlement of non-CIV funds**

We refer to the “treaty entitlement of non-CIV funds” consultation paper published on 24 March 2016 with a closing date for responses of 22 April 2016.

This response has been prepared by Jersey Finance Limited (JFL). JFL is a not-for-profit organisation, formed in 2001, to represent and promote Jersey as an international finance centre of excellence. We are funded by members of the local finance industry and through central funding by the States of Jersey Government. A full list of our members is available on our website. JFL maintains offices in Hong Kong, Shanghai and Dubai and representation in London, Mumbai and Delhi.

Through its various functions, JFL maintains a high-level of involvement and engagement with its members. This is achieved through regular meetings and events, attendance at trade association meetings and through its role as an intermediary for industry with both government and regulator e.g. on matters of policy, and the development of legislation and regulation.

This response has been prepared on the basis of discussions and views supplied by our membership. Whilst JFL does not represent Jersey’s finance industry in its entirety, and whilst we cannot guarantee that the views of individual members are not at variance with the views expressed, we are as confident as we can be that this response is broadly representative of an industry view. Whilst JFL is part-funded by Jersey’s Government, the Government has not contributed to this response.

**Jersey’s financial services sector**

Jersey has developed a respected funds sector that offers a broad range of fund regimes from regulated options through to the more sophisticated and institutional end of the
market. 1,320 funds\(^2\) are either established or serviced from Jersey with a net asset value totalling £225.8 billion and, in more recent years, has evolved into a specialist centre for the alternative asset classes, including hedge, real estate and private equity funds, which account for around 70% of its overall funds business.

**Jersey’s reputation**

Jersey is one of the best regulated international finance centres, a position that has been acknowledged by independent assessments from some of the world’s leading bodies including the OECD, MONEYVAL, ESMA and the IMF.

Jersey is fully aligned with the highest standards of the EU Anti-Money Laundering Directive and was one of the first international finance centres to become a full signatory to the IOSCO Multilateral Treaty, an international benchmark for cross border co-operation between regulators. Jersey was also an early adopter of the Common Reporting Standard, the global standard in Automatic Exchange of Information.

Jersey's world class reputation is continually strengthened by its on-going commitment to comply with international standards, regulation and transparency in certain finance centres. The Jersey authorities are fully committed to transparency and the exchange of information for tax purposes and Jersey's practices demonstrate a responsive and co-operative approach in these areas.

In an increasingly global world, there is growing demand for secure and efficient multinational transactions. Jersey offers tax neutrality to investors which means individuals and companies who are conducting business globally can pool investments from multiple economies to finance projects globally, efficiently and cost-effectively. Jersey’s robust legal framework and sound judiciary offer protection to investors who might be uncomfortable investing directly into riskier countries.

Through its strong links with London and other major cities, Jersey has deep access to capital markets for investment in infrastructure, telecommunications networks, machinery, buildings, homes and other physical capital to foster jobs and growth.

**Comments on the consultation**

We note the majority of questions, at least to some extent, refer to Limitation on Benefits (LOB). Many commentators and financial firms we have spoken with conclude that the LOB provisions, as included in the October 2015 report, are likely to be of interest to only a limited number of jurisdictions. We have, however, answered most questions where the LOB provision is mentioned as we think there are specific objective tests that could be incorporated into the amended model treaty in order to determine the appropriate entitlement to treaty benefits and prevent the scope for non-CIVs to engage in treaty

\(^2\) As of 31 December 2015
shopping. However, our view is that non-CIVs that are established in jurisdictions such as Jersey that comply with internationally accepted standards on transparency and information exchange are highly unlikely to be used for the purposes of treaty shopping, either directly or indirectly.

We also note part of the consultation focuses on the issue of whether a fund is widely held and/or highly regulated. These are two of the three tests that must be satisfied in order for a fund to meet the CIV definition. It is wrong to suggest that high regulation is an alternative to being widely held as retail funds will inevitably be highly regulated given the types of investors in those funds. The fact that a fund is not highly regulated is often down to the fact that the investors are not of the sort that would require a highly regulated product, so the funds sector has evolved to develop lightly regulated products to meet this demand. This will generally be the case when funds are held by institutional and/or sophisticated investors.

The possibility of amending the definition to capture widely held CIVs should also be explored. The non-CIV focus should be aimed at professional/institutional investor funds that will tend to have a smaller investor base, so much so that the challenge of looking through to the ultimate beneficial owners in such funds should be one that can be overcome in a majority of cases. However, it would be important to look at the status of the ultimate investors in order to establish if a non-CIV is widely/diversely held.

For ease of review, we have included our responses under each question included in the consultation document.

Questions

**Suggestion that Treaty Benefits be granted to regulated and/or widely held non CIV Funds**

1) **What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?**

As noted above in our opening comments, providing for an exception to the LOB rule for widely held funds may be of limited benefit to non-CIVs, which by their nature will typically be less widely held than CIVs; this is particularly so in areas such as hedge, private equity or real estate where illiquid assets are held.

However, if a widely held test is the objective here, the test should consider the fact that many funds are held through tiered structures. For example, this includes typical master/feeder structures. The test should also consider the nature of the investors as well as their number. Investors may themselves be widely held, such as pensions funds, listed entities and the like.

The UK rules around diversely held (non-close) companies could potentially be applied. As noted above the rules should allow for the fact that even closely held (fewer than 5 participators) entities may be treated as diversely held where the investors themselves are diversely held.
There should also be rules that allow for the fact that, for certain periods, some funds may not meet the “widely held” test. For example, this would include periods at the commencement of many fund life cycles when the fund is “seeded” by a few investors or when the fund is in the wind up period prior to termination.

Another alternative would be to look at the capability for non-CIVs to be marketed more widely. For example, certain funds in Jersey require regulatory approval to be marketed to more than 15 or 50 potential investors, and the fact that a non-CIV is able to be marketed more widely could, of itself be enough to meet the widely held condition, even if the offer is taken up by less investors than that permitted.

2) What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

Given that regulatory regimes for non-CIVs will vary significantly across jurisdictions, it will be challenging to easily define “regulated” for the purpose of establishing an exception to the LOB rule. It will be important to keep the rules as generic as possible, and focusing on the quality of the regulator and the level of implementation of established international regulatory standards is likely to be the best approach. The rules might focus on internationally recognised standards of transparency and AML.

In most jurisdictions, the level of regulation is proportionate to the number and/or type of investors who invest in the fund or to whom the fund may market. Therefore, funds that market to retail investors will inevitably be more highly regulated than specialist alternative investment funds such as hedge, real estate and private equity that will generally be marketed to selective groups of institutional and high net worth investors who, owing to their level of financial sophistication, have less motive for investing in highly regulated retail-type funds. For these lightly regulated private funds the focus should be on their regulatory requirements regarding records/transparency of investor information and, where it is established that a sufficient level of ‘good investors’ are in the fund, the treaty benefits should be available as if the investors had invested directly.

Jersey is fully aligned with the highest standards of the EU Anti-Money Laundering Directive and was one of the first international finance centres to become a full signatory to the IOSCO Multilateral Treaty, an international benchmark for cross border co-operation between regulators. Jersey was also an early adopter of the Common Reporting Standard, the global standard in Automatic Exchange of Information. Jersey has a well-established and robust central register of beneficial ownership information and all incorporations of Jersey companies require the services of a professional, regulated ‘trust and company service provider’ (TCSP). The Jersey authorities are also fully committed to transparency and the exchange of information for tax purposes and
Jersey's practices to date have demonstrated a responsive and co-operative approach in these areas.

If a prescriptive list of fund regulatory standards is deemed to be the preferred option, then regulations such as the Alternative Investment Fund Managers Directive (AIFMD) might be included but it would also be important to recognise equivalent legislation that may exist in locations not covered by the named legislation. It would also need to allow for the fact that certain regulatory regimes will be geographically specific. For example, a non-CIV established and managed from Jersey that targets non-EU investors would have no need to seek any kind of AIFMD authorisation.

It should also be noted that the regulation is not always at the fund level, but often at the level of the fund/asset manager. The rules should allow for this.

This test should not be with reference to investment restrictions given the highly diverse types of assets that are held within non-CIVs.

3) Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

It would be highly unusual for a non-CIV which is to be widely held to be formed with the principal purpose of obtaining treaty benefits.

If this issue is felt to be one that needs to be addressed, especially for narrowly held or lightly regulated non-CIVs, then an alternative approach would be to apply a derivative benefits test that looked to whether a sufficiently high proportion of investors were resident in jurisdictions that have a full DTA with the source country that provided a substantial reduction in the rate of tax applicable to the relevant category of income.

Allowing a fund with diverse investors to have a minority of investors that are not treaty qualified should not constitute treaty abuse where the fund was not established for the purpose of giving minority investors access to treaty benefits. Therefore, the model convention would need to specify a minimum level of 'good investors' that are required in a fund (looking through to the ultimate beneficial owners) in order for the fund to be able to enjoy treaty benefits. The question that needs to be resolved is what percentage of the fund's investors are required to be 'good investors' resident in a country that would have been able to enjoy the same or better rate as the non-CIV fund? It seems unjust to apply a higher threshold to non-CIVs than to normal business entities.

An additional (if the derivative benefits test could not be satisfied) or alternative approach would be to look through to the status of the investors in the fund and determine the relevant rate(s) of withholding tax that would have applied had they invested directly in the investment and then calculate a blended rate of withholding tax, weighted proportionately by each investor's interest in the fund. The fund could provide
its calculation to the withholding agent. The fund would need to ensure that the ultimate tax cost was allocated appropriately.

4) **Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution?** Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

Funds are not typically used to defer tax, although deferral of income may occur in some cases for valid commercial reasons. Tax should not dictate the distribution policy of any fund.

Many funds invest for long term appreciation of the assets held; forcing funds to make distributions may deprive funds of capital needed to fund further investments or working capital requirements. Tax avoidance is clearly not a motive in these scenarios.

Many non-CIVs, especially real estate and private equity structures, are established as tax transparent vehicles, meaning deferral of distributions would in any case not result in any tax deferral. Additionally, non-CIV fund classes such as private equity, real estate, and hedge funds will not typically retain uninvested capital in the fund so this is not a concern and should not need to be factored into the requirements.

With opaque funds, whether or not taxation arises only on distribution will vary depending on whether there are anti-deferral regimes applicable in the investors’ countries of tax residence. We strongly believe the deferral point should be dealt with through domestic anti-avoidance legislation in the investor’s country of tax residence (e.g. the offshore fund rules in the UK) and not as a treaty point.

5) **States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?**

Widely-held non-CIVs have essentially the same positive features as CIVs and should be treated in a similar way. The OECD recognised the economic importance of non-CIV funds in the October 2015 Report and we advocate the CIV definition, as a minimum, being expanded to include widely held non-CIVs to recognise the important role these funds play in assisting with the growth of a healthy global economy through cross border investment.

Notwithstanding the above, and the comments under question 4, it is acknowledged that many jurisdictions will not accept this outcome as described.
An alternative could be a form of extended derivative benefit test which effectively operated such as to determine access to treaty benefits by looking at the location of the assets and the residence of the ultimate investors irrespective of the corporate structure between the two. This would require identification of investors and their eligibility for treaty benefits on an investor by investor basis, which may be possible to a limited extent given the information available under FATCA, CRS and the TRACE project, but which would nevertheless represent a considerable administrative burden for the non-CIV industry. Funds of funds may have particular difficulties where there are multiple layers between the income arising in the source country and the ultimate investors.

An additional or alternative approach, as discussed under question 3 would be to calculate a blended rate of withholding tax to be applied by the country or countries where the investments are located. Given the volume of information available under existing transparency and reporting initiatives, as noted above, it may be possible for non-CIVs to prepare blended rate calculations, although it could nevertheless be a considerable compliance burden.

6) One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

Intermediate entity-level tax is typically withholding tax on interest or dividends or non-resident tax on capital gains. SPVs are commonly used to hold the assets below the level of the fund vehicle for a variety of reasons.

Intermediate vehicles are often tax transparent or established in tax neutral locations. Therefore, leveraging from either related or unrelated parties should have no tax consequences.

Intermediate entities are set up for a number of non-tax reasons, such as:

- To consolidate the investors’ tax reporting obligations that would otherwise exist in the country or countries where investments are located;
- Certain investors may be prohibited from having direct ownership of voting power in certain or any investments;
- Allocation and limitation of risk;
- Structuring co-investment; and
- To allow the management team of underlying businesses to have an equitable stake in the business.

*Non-CIV Funds set up as transparent entities*
7) Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

A possible solution would be to regard the transparent non-CIV fund (whether or not it is formed under the laws of the treaty jurisdiction or is managed there) as the representative of its investors and be entitled to make claims for the benefit of the tax treaties applicable to investors. At present it is very difficult for investors to obtain effective benefit of a tax treaty in these circumstances because the fund cannot claim on behalf of investors while the investors do not have the necessary information about the relevant investments. An administratively straightforward arrangement that would permit the non-CIV fund to claim on behalf of investors is desirable.

**Suggestion that the LOB include a derivative benefit rule application to certain non-CIV Funds**

8) The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

It can be difficult to define institutional investors unless it is by reference to tax exempt status and, if it were, then it should not be considered abusive to extend treaty benefits to an investor that is exempt from tax in its country of residence. However, institutional investors may include taxable entities or other funds and to exclude these would excessively narrow the application of the rule.

Eligibility for treaty benefits should be determined on first principles of residence etc. - or by virtue of a PPT - not trying to define a generic class of investor.

Our responses under questions 3 and 5 discuss alternative approaches that could provide a workable solution for non-CIV funds.

9) Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?
All non-CIVs are vehicles for collective investment. However, there is no consensus on the distinction between CIVs and non-CIVs.

Any regulated non-CIV in a jurisdiction which complies with internationally recognised standards of transparency and AML law should be recognised.

The types of investment may vary considerably from equity to alternative sources of investment (such as debt instruments). Non-CIVs will not necessarily hold a diversified portfolio of investments and investor protection may be limited.

However, also common to these entities is that their investments are managed, directly or indirectly, by an investment manager, which in Jersey would be a regulated financial services business.

10) Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

The LOB and PPT (where countries choose to include them) will help to target attempted abuse of the treaties.

In addition, the derivative benefits test has criteria for its applicability, which could be viewed as anti-abuse rules.

11) What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?

The fact that a fund’s investment manager is in the trade or business of providing investment services, is subject to general regulatory oversight, and has an investment management agreement with the fund, should entitle any directly or indirectly managed investment vehicle to meet this bona fide investment objective.

12) How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

There are a number of tests which could be based on existing regulatory legislation, practice and product types and asset classes which are already used in the market (e.g. that a fund is intended to be and may be marketed to a diverse investor base with appropriate PPM disclosures and investment restrictions and objectives, in accordance with existing regulatory regimes).

Questions related to the identification of the investors in a non-CIV

13) Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

This will vary from fund to fund but would generally be more stable, particularly in the case of non-listed private equity, real estate, or hedge funds.
14) **How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?**

Most non-CIVs will have, over recent years, been required to collect data on ‘controlling persons’ under initiatives such as FATCA and CRS. However, controlling persons does not necessarily capture ultimate beneficial owners; as a controlling person generally relates to the immediate owner of an entity, multi-tiered structures will have challenges here.

The move towards creating registers of ultimate beneficial ownership information further demonstrates that funds and fund managers will need to have the capabilities to understand who the ultimate investors are and where they are resident. Admittedly this may not capture all ultimate beneficial owners as the rules may only require those with a beneficial interest above a certain level to be identified, but nevertheless a requirement to look through to ultimate beneficial owners will still arise and therefore expanding that capability to deal with any requirements imposed from the Action 6 outcomes could be achievable.

The concept of tracking ultimate beneficial owners and passing that information down the chain of ownership already exists under certain US tax provisions and therefore this type of process could be also adapted to deal with Action 6.

Regulated financial services businesses in Jersey, which include fund managers and most funds have been required to collect information on ultimate beneficial owners (above certain thresholds depending on a risk rating) since 1999. However current requirements typically only relate to persons with a significant interest in an entity and as noted above, expanding this requirement to look at all investors will create a significant administrative burden.

It is accepted that the requirement to track ultimate beneficial owners may prove more challenging for certain funds (especially fund of funds structures) but if the non-CIV cannot determine its beneficial owners, it will be unable to benefit from the derivative benefits test. Indeed, some non-CIVs may determine that the administrative complexity of establishing and maintain a register of ultimate beneficial owners outweighs the potential treaty benefits of doing so.

15) **What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?**

See response to question 14 above.
Additionally, the requirements under FATCA and CRS do not extend to establishing an investor’s entitlement to treaty benefits and as noted above, a fund may not currently have any requirement to establish who the ultimate beneficial owners are.

16) Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

See response to question 14 above.

Our responses under question 3 (blended rate test) and question 5 (extended derivative benefit test) could provide a workable solution for non-CIV funds but each of these options will create significant extra workloads and costs at the fund level in order to establish which investors are entitled to treaty benefits.

Where the treaty entitlement of investors needs to be established, creating a uniform approach to achieving this should be developed. For example, in the US W-8 and W-9 forms are used and are generally well understood by the funds sector. If funds are required to establish additional information about investors, it is imperative that an internationally agreed standard is developed (jointly with interested parties) for capturing this information in order to reduce the administrative burden for funds and their service providers.

**Questions related to the prevention of treaty-shopping**

17) Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

The simplest way of applying the test is to look at the location of the assets (the ultimate source of income and gains) and the residence of the ultimate investors while disregarding everything in between. While this may be difficult to administer in practice, Jersey has captured ultimate beneficial owner details since 1999 and this demonstrates that it is possible, albeit that the requirements under the proposal would require the identification of all ultimate beneficial owners and not just those with a “significant interest” unless a minimum ownership threshold was included in the proposal.
The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

As noted elsewhere in our response, we believe that it is highly unlikely that non-CIVs are being established with the primary purpose of accessing treaty benefits. It has been accepted that non-CIVs perform an important role in the global economy, and on this basis we cannot understand why the percentage of ‘good investors’ should be any higher than standard business entities.

We think it is sensible to include some sort of threshold in order to give some flexibility where the treaty status of some beneficial owners is not able to be readily determined. 80% is a high enough mark to severely limit the opportunities for treaty shopping.

As noted elsewhere in this response, an alternative approach is to restrict the claim for treaty relief to the percentage of the ownership which had been identified as qualifying, and the non-CIV would then allocate the benefit of the partial relief claimed accordingly. This is discussed under questions 3 and 5.

One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

Given that 50% is generally accepted for non-fund entities then we see no reason why funds should be subjected to a more onerous test.

Questions related to the prevention of deferral

According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

This is a domestic law point that should be determined by the countries in which the investors are resident as it is those countries’ tax revenues that are potentially being deferred.
21) As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

As noted above, deferral is not, in the majority of cases driven by a motive to avoid tax.

Looking up to the ultimate investors in a fund structure would ensure that treaty benefits are only provided to those investors that would have obtained the benefits had they invested directly. Given the complexities in establishing the identity and residence of each ultimate investor this may be unworkable for some funds (especially fund of funds).

Questions related to the new derivative benefits provision of the United States Model

22) The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016 (see https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-206.pdf, paragraph 4 of Article 22 “Limitation on Benefits”). Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

The US Model derivative benefits test should not be the standard for the non-CIV derivative benefits test. The only relevant comparison is that both tests are based on the premise that if the owner(s) of the tested company could have received equivalent benefits directly, there is no treaty abuse. Further, the US Model derivative benefits test is excessively complex and most of the bases for this complexity are not relevant to non-CIVs.

Suggestion that a “Substantial Connection” approach be adopted

23) Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

Suggestion of a “Global Streamed Fund” regime

24) Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite
commentators to offer their views on its different features. In particular, the Working Party invites comments on:

a) Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?

b) Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?

c) Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?

d) What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

We think this proposal warrants further investigation as an alternative option. The proposal should be workable in closed ended narrowly held funds where it is possible for the fund to determine its ultimate beneficial owners.

This proposal will only be workable if a sufficient number of jurisdictions agree to its introduction. It would be necessary that holding companies under the non-CIV vehicle would also be eligible for GSF status.

The GSF scheme should be elective as for some funds, especially those with a diverse investor base and high turnover of investors or investments, as the administration challenges may make this unworkable.

In relation to point d) above, the erroneous payments, could, as far as possible be corrected through future payments. This would only work where the investor receiving the erroneous payment also received another payment from the same source. A similar ‘netting-off’ system was proposed under FATCA, but for a majority of countries the risk of incorrect withholding did not arise following the introduction of the IGAs. Penalty provisions may also want to be considered, but given the difficulties in enforcing cross border non-compliance, the jurisdiction where the fund claiming GSF status is established would probably need to enforce the penalty.

As noted elsewhere in this document, deferral is not, per se, an abusive act and there are many valid commercial reasons why income and gains may be deferred.

Additional examples for the commentary on the PPT Rule

25) Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

Concerns with respect to conduit arrangements
26) Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

**Concerns related to the “Special Tax Regimes” proposal**

27) Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released in February 2016 (see question 22 above). If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

**Other Suggestions**

28) Please describe briefly any approach not already mentioned in this consultation document or in previous comments that could address concerns related to the way in which the new treaty provisions included in the Report on Action 6 may affect the treaty entitlement of non-CIV funds without creating opportunities for treaty-shopping or tax deferral.

We do hope these comments are helpful and should you wish to further discuss any of the points raised please do not hesitate to contact us.

Yours faithfully

Richard Corrigan
Deputy
Dear Marlies,

Treaty Entitlement of Non-CIV Funds: Public Discussion Draft published on 24 March 2016 (the “Discussion Draft”)

We are pleased to have this opportunity to set out our view on the serious unintended consequences that would arise from the implementation of Action 6 guidance without further guidance and clarity from the OECD.

There is a significant risk of treaty benefits being withdrawn from long-term investment arrangements and a default in practice to domestic withholding tax rates (notwithstanding the underlying investors may be eligible for treaty benefits). This disruption would affect availability of long-term capital and restrict the types of investment arrangements available.

It is therefore important that a solution is found to facilitate continued growth of long-term investment into alternative asset classes such as infrastructure and real estate in joint ventures, consortia, and funds alongside other like-minded investors. We understand that this is a priority for the OECD in the same way that tackling tax abuse is.

The two general concerns expressed by governments about granting treaty benefits to non-CIV funds are that:

1. Non-CIV funds may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits; and

2. Investors may defer recognition of income on which treaty benefits have been granted.

In our response we have sought to aid greater understanding of the long term investment model so that governments have comfort to provide greater clarity through guidance and examples.

This response is predominantly focussed on the implications and impacts of countries adopting a principal purpose test (“PPT”) approach into their tax treaties as we understand that the majority of European OECD Member States are likely to support and/or adopt such an approach to the granting of treaty benefits (rather than the Limitations on Benefits (“LOB”) approach).
We have set out in this response a series of challenges and examples drawn from our general experience with non-CIV funds and their investors and the typical investment structures that are used. We hope that the OECD will consider the key issues that arise from a lack of certainty around these areas and will seek to include in the AP6 commentary guidance and clarity to address these concerns. The final section includes a suggested example for the model commentary which draws together these comments.

We hope the OECD will consider using this example to form part of its guidance on AP6.

We appreciate your consideration of our comments on the Discussion Draft and would welcome the opportunity to assist the OECD further in this area. If you would like to discuss this response further, please do not hesitate to contact Naz Klendjian (naz.klendjian@kpmg.co.uk), Margaret Stephens (margaret.stephens@kpmg.co.uk) or Sarah Goodman (sarah.goodman@kpmg.co.uk).

Yours faithfully

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1 Executive Summary

Additional OECD guidance, which is specific to the application of the PPT to non-CIV Funds, can benefit the continued flow of long term capital investment from Pension Funds and Sovereign Wealth Funds (“SWFs”). This can be achieved without at the same time benefiting investors with a principal motive of treaty shopping without direct entitlement, or deferring recognition of income.

Without such guidance, there is a significant risk that Pension Funds and SWFs, who would be entitled to tax exemption and/or treaty benefits had they invested directly, would suffer unanticipated, full source country domestic withholding tax rates on their returns from long term investments through non-CIV funds which invest in those same source countries. We understand this is not the intention of BEPS Action 6.

In this response we have sought to explain who and what are non-CIV funds and why they are needed by investors to access investments which meet their return and risk requirements. We include material which demonstrates the significant growth in investment through non-CIV funds into “alternative investments” since the global financial crisis.

We have also sought to explain that, due to the nature and objects of non-CIV Funds, deferral of taxation on income within funds is not a feature which should be a concern for governments. We explain the reasons for the variety of models and seeming complexity of investment structures.

Particular jurisdictions have emerged over many years as attractive by reason of their treaty network and holding company frameworks. They are now well established and understood by investors and fund managers. Non-CIV funds established in these jurisdictions will provide access to treaty benefits to all investors irrespective of whether they would be entitled to them on a direct investment. However it is a fact that the substantial proportion of investors would be entitled to exemption or treaty benefits and their motivation is to pool investment, access specialist expertise and deal origination capabilities within fund manager teams, and share risk with others. Guidance will help achieve a consistency of approach between source countries and promote an understanding of the purpose of investors in a non-CIV fund.

In the case of investors who may indirectly receive greater benefits than they would in the case of a hypothetical direct investment, this is not their principal purpose, and would in any case be difficult for any one investor to achieve where a fund manager is adopting a structure to appeal to a wide range of different investors from different countries, that will invest in different source countries. If a non-CIV fund fails the principal purpose test ("PPT"), we would ask the OECD to recommend that a look through approach is adopted such that investors who would otherwise be
entitled to treaty benefits are not penalised through the imposition of full source country withholding tax.

We have set out examples of situations which demonstrate challenges in applying the PPT and suggested solutions and guidance including one example which we suggest is included as OECD guidance.
2 Background and industry context

2.1 Non-CIV funds and institutional investors

Non-CIV funds comprise a variety of investment models to enable investment by mainly ‘institutional’ (or ‘wholesale’ / ‘sophisticated’) investors (as opposed to ‘retail’ investors or ‘mums and dads’) into primarily illiquid or unlisted assets, sometimes referred to as ‘real assets’ or ‘alternative’ assets. Investments into such assets are primarily in the three sectors of Infrastructure, Real Estate, and Private Equity. For illustrative purposes throughout this response, examples given are with respect to non-CIV funds investing into Infrastructure, although most of the examples and comments are equally applicable to Private Equity and Real Estate, all of which are important and strategic asset classes for managed funds and institutional investors.

‘Non-CIV funds’ is a term which covers specialist funds (‘managed funds’) managed by external asset managers (General Partners, or ‘GPs’) into which institutional investors invest (as Limited Partners or ‘LPs’). For clarity, the terms ‘GP’ and ‘LP’ are commercial references to the investor and the manager – in practice, non-CIV funds which bring together capital and expertise are established in various different legal forms such as companies, partnerships and trusts, based on local/regional investor familiarity and market-practice.

‘Non-CIV funds’ can also encompass the investors themselves, comprising mainly Pension Funds and Sovereign Wealth Funds (‘SWFs’) and insurers. ‘Institutional investors’ is a term commonly used to refer to Pension Funds and SWFs who typically invest into real assets ‘directly’ or ‘indirectly’ via specialist fund managers. In its broadest sense, it also covers insurers, endowments and foundations (i.e. pools of funds established to provide ongoing funding to organisations such as schools, hospitals, churches etc.).

Pension Funds and SWFs in particular, are important sources of long-term capital and investment, investing directly and indirectly through investment entities. Whilst most comments in this response are not exclusively relevant to SWFs, we note that SWFs spent a total of US$43.5 billion on 184 direct investments in 2013 and had over US$7 trillion of assets under management as at December 2015. Similarly, the top 300 pension funds (including sovereign funds) had an estimated US$15 trillion of assets under management. The combined assets of these institutional investors total about US$50 trillion and represent the biggest source of untapped private finance.

2.2 Treaty shopping and income deferral

Based on the OECD’s work to date around changes to the OECD Model Tax Convention (‘MTC’) to ensure that, for treaty purposes, Pension Funds are resident in the States in which they are constituted, governments recognise the purpose served by Pension Funds as key global investors.

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who should be entitled to treaty benefits irrespective of their home country taxation policy to treat them as wholly or partially exempt.

Pension Funds and SWFs account for the significant majority of investment into non-CIV funds. Both are eligible for treaty benefits in their own right and are generally tax-exempt in their home jurisdiction. In this regard, governments can afford to be less concerned around the risk of (a) treaty benefits being granted to underlying investors that would not otherwise be entitled to treaty benefits and (b) the deferral of taxation of income to underlying investors.

In a non-Pension Fund/SWF context, many non-CIVs are transparent for tax purposes and there is therefore a significant incentive to distribute (and not defer) cash to investors, to enable them to fund their tax liabilities on an ongoing basis. Many countries also have anti-deferral rules of some description in place.

2.3 Models of investment

With reference to the infrastructure sector, the following diagram illustrates the different ways in which institutional investors and managed funds participate individually or together in infrastructure investment.

At one end of the spectrum, institutional investors invest ‘indirectly’ into managed funds, delegating investment origination, execution and strategy to the managed fund, which then invest into assets across a region (see later Example 4 in this response). At the other end of the spectrum, institutional investors (sometimes in consortia) invest ‘directly’ into assets, in-sourcing all investment origination, execution and ongoing asset management functions (see later Examples 1 and 2 in this response).
There are a variety of investment models in between, such as co-investing, where an institutional investor invests in a fund run by an asset manager and then may have the opportunity to make direct investments alongside that managed fund (see later Example 3 in this response). Since fees are generally not charged on co-investments, institutional investors making co-investments can leverage the skills of the fund manager while paying lower fees in aggregate.

2.4 Use of investment ‘platforms’

Regional / intermediary ‘platforms’ are an essential part of investing into non-CIV alternative assets because of the ‘global-local’ nature of the investment/capital flows and the manager/service flows in the investment value chain. We have included further details regarding the industry context for the non-CIV investment value chain in Appendix 1.

The diagram below depicts this for additional clarity:

a) Traditional managed fund model (left side) - Institutional investors make an initial decision (in their home country) to select a manager. The manager will typically have personnel located in its own home country and proximate to the countries in which it is intending to invest. As such, it will establish a suitable long-term structure for investment into multiple jurisdictions in the region. When determining where to establish the
platform, the availability of a broad double tax treaty network was one of a number of considerations.

The investors may invest via a pooling vehicle (such as a partnership or trust) which also contains the governance arrangements as between the institutional investors (LPs) and the fund manager (GP) (and into which investors may come and go in the future). Once transaction-specific and fund-specific obligations / liabilities are discharged, the fund manager is then able to distribute funds from the platform to the underlying investors in accordance with the return requirements expected by the investor.

The fund manager may have complete discretion over the cash flows received by the investment platform from its underlying investments. In such circumstances, the investment platform is itself a substantive intermediary part of the investment value chain and in the conventional sense of treaty entitlements has discretion (or beneficial ownership) over the cash flows from the investments e.g. it must first be able to discharge expenses and costs of investment from that level. Such platforms are not ‘conduit’ entities, nor are they ‘shell’ companies established to generate treaty entitlements that would not otherwise be available. Rather, there is ‘real’ investment holding company activity undertaken at the level of the platform.

At the time the fund and its platform is established, it may not be known exactly which countries the fund will invest into in the future. In order to ensure that the fund does not encounter a material disadvantage in terms of unnecessary double taxation on top of source country taxation on the local profits earned in each investment country and also to remain competitive (i.e. are low-risk, non-aggressive and stable over the long term), the fund would take into account jurisdictions which have the broadest treaty networks available.

Funds with a European mandate, for example, commonly select jurisdictions such as the UK, Netherlands and Luxembourg for their platforms as these have strong locally-based market-specific personnel in their particular investment management industries, more so than, say, the home country of any one underlying investor, or the source countries in which the investments are made.

Once a fund establishes its platform in such a jurisdiction and makes its first investment into a source country, it then commonly uses that jurisdiction when making further investments, even into different source countries.

b) **Co-investment in specific assets (right side)** - Certain more sophisticated and/or larger institutional investors also invest or co-invest with each other ‘directly’ into specific assets as part of their ‘direct’ investment programmes (as well as into non-CIV funds). Often, this is also done through a regional investment vehicle or platform, for the same reasons outlined above.
As direct institutional investors look to deploy their capital over a long-term horizon into a pipeline of future deals, they also locate personnel outside of their home country as part of the ‘global-local’ aspect of non-CIV investment, to source, execute and manage transactions on a day to day basis. As with managed funds, investment through a regional investment platform allows them to do this. When co-investing alongside other institutional investors from different jurisdictions, they commonly require a consortium vehicle that is acceptable to each underlying investor where the funds and cash flows are also pooled to manage and discharge costs of transaction specific service providers and/or lenders in time zone and proximate to the underlying asset.

c) The dotted line on the diagram illustrates that, in many cases, co-investment into transactions happens alongside managed funds and institutional investors, who commonly come together in large transactions, where, for example, the fund manager has sourced the investment opportunity and will manage the investment on a day to day basis, but the transaction is of a size and scale that requires funds to be obtained directly from institutional investors as well as from the managed fund.

In all these cases, there is an evident and bona fide series of purposes surrounding the investment platform (pooling of funds, managing of funds as between investors, manager, lenders, service providers, proximity of platform to manager/service provider and underlying assets in order to conduct day to day investment management business, local market and regulatory expertise and so on), in addition to the consideration of efficiently managing tax leakage. The tax considerations form part of a broader investment package offering investors a market practice structure that is at least commercially accepted as one that limits material double taxation between the post-tax profits from the investments and the distributions to the fund investors.

The intermediary structures depicted therefore reflect how services, funds and locality are brought together into the value chain that underlies the overall capital flow. Whilst the choice of establishing a platform in a jurisdiction with a good treaty network is partly motivated by the desire to replicate broadly the position that would have arisen had the same pool of investors invested directly into the underlying assets, that objective should be viewed in the context of the wider range of legitimate commercial objectives relating to the running of the fund. We do not think the effect of a PPT should be to penalise the coalescence of capital and services through the interposition of multiple taxes at each ‘layer’ where capital flows and service functions are combined.

We consider that the key to a consistent and meaningful interpretation of the PPT in the context of non-CIV funds across the broad trajectory of investment models needs to take into account the breadth of commercial structures prevalent in the market and be grounded in the reasons why such investors / funds hold their investment through intermediary platforms as outlined above.

The above contextual background of the non-CIV industry and its investors / investments is intended to provide the backdrop for the subsequent section which details the consequential types of legitimate investment arrangements that emanate from the drivers and purposes outlined above.
It highlights the practical issues to consider when interpreting a PPT rule in relation to such structures and suggests a basis for examples that could be included in the commentary that capture the main themes outlined above.

The examples set out on the following pages identify typical investment structures within the non-CIV industry and seek to further identify the ramifications that may inevitably arise without clear guidance from the OECD. Examples 1 to 3 address how certainty around a PPT could be achieved in the OECD commentary. Example 4 deals with the implications of failing a PPT and how a ‘look-through’ approach could be implemented so as to not result in a blanket denial in treaty benefits if a PPT is failed at an intermediary level in a structure.
3 Example 1(a): Direct investment via a regional investment platform

In the context of the above introduction to the typical structure and purposes of SWFs, Pension Funds and other funds, the example below considers the availability of treaty relief in respect of dividends for a sovereign wealth fund (“SWF”) investing into Europe through its own ‘captive’ regional investment platform.

SWF is tax resident in State T and has four wholly owned subsidiaries in four different European states. State T has tax treaties in place with each of State G, F, I and U. Each subsidiary’s core business activity is to invest in real estate in their respective local jurisdictions in which they are subject to local taxation. The subsidiaries are held via L Co, which manages the investments and has some local economic activity and employees. L Co is resident in State L (also in Europe), which has a tax treaty with State T.

What is the PPT and what is required for L Co to satisfy the PPT?

(a) What is an acceptable purpose of L Co? – OECD guidance should clarify that the purpose of the PPT is to target arrangements that are ‘artificial and contrived’, rather than to scrutinise genuine commercial purposes for the use of a particular intermediary jurisdiction. It is important that the OECD provide an indication of what it considers to constitute genuine commercial purposes. In lieu of it being possible to list all the reasons highlighted above, we recommend the OECD commentary include reference to what it considers may be acceptable reasons under the PPT for the establishment of an intermediary vehicle in a particular jurisdiction, including (but not being limited to) the following:
- Greater connectivity with local markets, other market participants and underlying investments in jurisdictions within relatively close proximity to the intermediary vehicle(s);
- Recruitment of talent, including access to locally based (multilingual) directors and service providers with regional business practice, regulatory environment and legal framework expertise;
- Access to an appropriately qualified workforce/fund managers that can exercise a consistent approach of good governance and stewardship of investments in the region;
- Investor familiarity (more specific to managed / pooled funds);
- Economic, legal and political stability; and
- Time zone efficiencies.

(b) *How relevant is L Co’s ‘substance’ in determining its purpose?* – The OECD has made it clear that the PPT is a test of ‘purpose’, not a test of ‘substance’. However, it cannot be denied that the presence of substance in a particular jurisdiction generally reflects bona fide commercial purposes for choosing a particular holding jurisdiction, which outweigh ‘ancillary’ tax reasons. In recognising that ongoing investment/asset management often occurs largely at the investment company level and major economic decisions (e.g. ultimate decision to commit capital) will be made by the ultimate investors, consideration should be provided in the commentary as to what specific substance may be required at the L Co level.

The guidance should clarify that this should not be the same substance that is required of a conventional / operational trading business and should reflect the reality of investment management activities mentioned above. For example. It is common for funds to have personnel located in the UK which are focused on deal origination and sourcing investments across the region. The investment platform (i.e. L Co) is often where local personnel and/or service providers are charged with the day to day investment management activities and the ongoing running/stewardship of the acquired assets. These are distinct activities which require different skills, a commercial reality which should be reflected in OECD guidance.

(c) *SWF considered the broad tax treaty network that State L offers in determining where to establish L Co. How does this impact the application of the PPT?* – Often, one factor of many in the decision to use a particular jurisdiction is that it is attractive to investors because it offers broad treaty networks. This should not in itself result in a failure of a PPT. The underlying purpose of tax treaties if to encourage and facilitate cross-border investment and it would be contradictory to this purpose for the PPT to be failed where tax impacts are taken into consideration when determining through which jurisdiction to invest.
(d) **There is no additional tax treaty benefit to SWF in investing through L Co** – It should not be possible to fail the PPT in circumstances where no tax benefit is generated from the use of L Co as compared to investing directly from State T to State G/F/I/U (for example, where SWF holds interests in a project resident in State G through L Co and the dividend/interest withholding tax rate under the State T – State G treaty is the same as the rates under the State L – State G treaty).

(e) **SWF has a ‘deal origination’ team based outside of State T and State L** – The deal origination team is responsible for sourcing investments for L Co. Personnel are strategically located in offices throughout the region (and not solely in State L), following which the intermediary platform employs/contracts locally in relation to the stewardship and day to day running/investment management of the ‘acquired’ investments. OECD commentary should include recognition of this common investment structure and confirm it is not intended that geographic separation of the deal origination team from the investment platform would, in itself, constitute a failure of the PPT.

(f) **How does the PPT interact with the EU Parent-Subsidiary Directive (“PSD”)** – Consideration should be given and guidance provided as to how the PPT should interact with the PSD where the PSD rules often (at a practical level) resolve themselves into a substance requirement. Which has priority or do they apply cumulatively?
Example 1(b): Direct investment via a regional investment platform (multiple subsidiaries and/or sister companies)

As demonstrated in the below structure diagram, and as a variation to Example 1(a) above, a common platform structure would involve L Co having multiple subsidiaries (or sister companies) in the intermediary jurisdiction, with each being responsible for a specific investment (e.g. each subsidiary) or management/employment (e.g. sister company) function.

The use of this investment structure with the separation of particular functions within a platform should not in itself impact the satisfaction of the PPT. It is common that the regional platform may invest through investment-specific subsidiaries or sister companies established in State L for organisational purposes, flexibility and accommodating co-investors. In particular:

1) L Co may establish subsidiaries and/or sister companies to undertake specific investment activities within the region and ring-fence particular assets;

2) An investment platform would comprise a series of separate entities (e.g. discrete and/or decentralised silos for real estate, private equity and infrastructure investments and/or to accommodate co-investors, reflecting the fund’s preferred operational and organisational structure); and/or
3) The management team for such entities would consist of local employees and/or outsourced investment management service providers centralised within a single entity (or very few entities) in the structure and would provide services contractually to any additional subsidiaries/entities located within the jurisdiction.

OECD guidance should contain confirmation that where an investment platform comprises a series of separate entities reflecting a preferred operational and organisation structure, the principal purpose for the establishment of the regional platform should be considered with reference to the fund’s economic and commercial nexus to the jurisdiction as a whole, rather than on a ‘bottom-up’ entity-by-entity basis and should not, of itself, cause treaty benefits to be denied.

Further to the above point, there may also be a range of interposed entities that have not been depicted in the above structure and were established or acquired historically due to specific financing arrangements, source country legal preferences around stamp duty and for flexibility on exit. As an example, UK real estate was often only commercially available to buyers through the purchase of offshore companies established by the sellers (e.g. Luxembourg and/or Jersey companies), due to local domestic law preferences. Again, OECD guidance should take account of this common structure and ensure that lack of certainty does not result in the worst-case scenario of failing a PPT.
Example 2: Indirect investment into Europe outsourced to a fund manager

In the common example below, an unlisted wholesale real estate ("RE") fund is established by an international bank to invest in real estate in France. An Australian institutional investor is to hold 15% of the fund and will have certain governance rights regarding the fund. Rather than investing directly into the fund from Australia, it holds the asset through either its regional European (e.g. UK) office or through appointing an external manager to act as the nominee for the institutional investor in the country in which the manager is based.

Due to the geographical and time zone differences between Australia and France, it is difficult for the institutional investor to exercise its governance rights directly from Australia. The Regional holding vehicle or the external manager manages the investor’s governance rights in an efficient manner.

5.1 What level of ‘economic activity’ is required for Regional holding vehicle to satisfy the PPT?

If economic activity is required in order to satisfy the PPT, treaty benefits would only be available to Regional holding vehicle where is conducts economic activity (and is tax resident) in that jurisdiction.

Investment management focuses on conducting such economic activity by driving operational value and making major decisions on refinancings, capital expenditure, regulatory price resets etc., that require close monitoring and local decision-making. Many of the smaller institutional investors/funds which have capital to deploy but small or non-specialist teams, are therefore
attracted to being able to outsource the active asset management aspects of their investment programmes to fund managers that provide the ‘deep’ sub-sector and/or country experience. Some of the larger institutional investors/funds also invest in managed funds as part of their strategic investment programmes because the fund manager’s deal origination capability provides the institutional investor with an ongoing pipeline of potential transaction.

Our view is that the legal separation should not of itself mean that the institution’s investing vehicles do not themselves have substance as they still have to actively procure, oversee and decide on the recommendations of the fund manager.
Example 3: Indirect investment into Europe through a ‘master’ vehicle

In the example below, long-term investors invest into a ‘master’ fund vehicle, which provides a single access point to a global portfolio of infrastructure assets (e.g. in the US, EU and Australia).

The ‘master’ vehicle is a transparent ‘pooling’ vehicle which is familiar in form, geography, time zone and regulatory regime to the majority of investors. The ‘master’ vehicle is established to enable ‘investor level’ activity to occur within a flexible and well-serviced fund-administration legal regime.

The fund master vehicle outsources investment advisory and fund / asset management functions (i.e., origination of transactions and ongoing asset management) to the Fund Manager which has many investment, management, finance and legal personnel located in ‘hub’ offices such as London, New York, Sydney, and satellite locations depending on the fund master vehicles investment mandate.
The fund establishes a US holding company (e.g., to borrow from banks to fund asset acquisitions), which is ‘checked open’ (i.e. transparent) for US tax purposes, which facilitates the application of investor-specific US tax treaties, depending on investor jurisdiction and type. The fund also establishes a regional EU-based investment platform (as per examples 1 and 2).

From a practical perspective, the use of a corporate (opaque) EU regional investment vehicle (as opposed to a fiscally transparent vehicle) is standard practice because it simplifies the complexities and uncertainties that would otherwise arise in considering how each and every EU source country might characterise the vehicle under its local fiscal regime and, in turn, how each country would apply source country withholding taxes and treaty entitlements across an underlying investor base spread across multiple jurisdictions.

A corporate regional holding platform undertaking investment holding and management activities thus also serves the administrative purpose of limiting (i.e., simplifying) the treaty-based analysis to the bilateral agreement between the source country and the regional holding company. Given the underlying investor base of pension funds (that are, in the main, exempt) who would otherwise be entitled to treaty benefits directly, the motivation for BEPS through treaty abuse is low.

However, without sufficient clarity on how the PSD/PPT would be applied to the bilateral flow between each EU source country and the regional EU investment platform, there is a risk that the corporate platform between the investors and the underlying assets could cause the Fund (particularly if investors are majority non-EU based) to fail the source country and/or anti-abuse or purpose tests, notwithstanding the wider investment management activities that are undertaken (via the Fund Manager) in the EU platform.
7 Example 4: Consortium direct investment into Europe

As demonstrated by the below diagram, a toll road project is located in State E and is held by a company resident in State E, TargetCo (which is wholly owned by BidCo, also resident in State E). Third party lenders require that BidCo is established in order to acquire TargetCo. To form a consortium and pool capital, Pension Fund 1 (“PF1”) (through its regional platform “Regional Co”), Pension Fund 2 (“PF 2”) and a global infrastructure fund (“Infra Fund”) establish Consortium Co in State D, a jurisdiction with clear rules on CIVs and which provides recognition of both civil and common law jurisdictions (e.g. Luxembourg or Ireland), to own BidCo.

Consortium Co has investment holding structure activities and functions commensurate with being an investment holding company. The Consortium either appoints an external manager or directly employs experts to manage the investment in State D. There are treaties between State E and each of States A, B, C and D. Each treaty is identical to the OECD Model Tax Convention.

BidCo pays interest and dividends to Consortium Co. Under the domestic law of State E, such payments would be subject to a 30% domestic withholding tax. Under the treaty between States D and E, they would be subject to 10% and 5%, respectively.

7.1 What happens if Consortium Co fails the PPT?

Where Consortium Co does not satisfy the PPT and if State E decides to impose a 30% withholding tax, investors would suffer a materially adverse result. However, these results would be ameliorated where Consortium Co is permitted to claim treaty benefits on behalf of its investors, or facilitate claims by the investors. Where appropriate identification and documentation is obtained (see comments below), benefits may be granted under the treaties between State E and States A, B and C, respectively.
Our view is that if the PPT is failed in relation to the intermediary jurisdiction, State E should be able to exercise its discretion to give effect to the treaty rate that would have been available had the investment been direct from State A/B/C to State E. OECD Commentary currently provides an option that countries can include provisions in their treaties to allow the Competent Authority to grant benefits on a look-through basis where the intermediate entity fails the PPT (a “look-through” approach).

The commentary should include a direct reference to the following (para 8 of page 64 of the 2015 Final Report – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) to give effect to this principle:

“Where a benefit under this Convention is denied to a person under paragraph 7, the competent authority of the Contracting State that would otherwise have granted this benefit shall nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement referred to in paragraph 7. The competent authority of the Contracting State to which the request has been made will consult with the competent authority of the other State before rejecting a request made under this paragraph by a resident of that other State.”
8 Suggested example for inclusion in OECD commentary

We have included below a suggested example for the model commentary which draws together our comments contained in this response. This example seeks to (a) provide clarity on what may constitute satisfaction of a PPT and (b) confirm that where a PPT is failed, a look-through approach to underlying investors should be applied for the purpose of granting treaty benefits. We encourage the OECD to consider using this example to form part of its guidance on AP6.

“RCo, a company resident in State R, is a wholly owned subsidiary of a pension fund (the “Fund”) established and subject to regulation in State T. RCo operates exclusively to earn income for the benefit of the Fund. RCo’s organisational purpose is to acquire and manage a diversified portfolio of private market investments located in countries neighbouring State R and to generate an investment return over the long-term as the regional investment platform for the Fund. RCo’s investments include equities, financial instruments, infrastructure and property. The commercial reasons for the establishment of the regional investment platform in State R include:

- connectivity with the local markets and other market participants;
- recruitment of talent, including access to locally based (multilingual) directors and service providers with regional business practice, regulatory environment and legal framework expertise;
- access to an appropriately qualified workforce that can exercise a consistent approach of good governance and stewardship of the Fund’s investments in the region;
- its economic, legal and political stability; and
- time zone efficiencies.

RCo’s management team consists of local employees and/or outsourced investment management service providers (e.g. trustees, legal, financial and tax compliance service providers). The team is experienced, located in proximity of its investment territory and has responsibilities including the following:

- reviewing investment recommendations from the Fund’s global investment teams;
- making and executing investment decisions within the remit of delegated authority;
- monitoring investments’ performance;
- carrying on treasury functions;
- acting as directors on the boards of directors of entities in which RCo has invested;
- maintaining RCo’s books and records;
- ensuring compliance with regional regulatory requirements; and
- providing services contractually to any additional subsidiary or sister/entities located in State R.

Amongst its portfolio of other investments in the region, RCo currently holds a 40% interest in an company resident in State S (which holds an investment in an infrastructure project in State S), in respect of which it receives annual dividends. Under the convention between State R and State S,
the withholding tax rate on dividends is reduced from 30 percent to 5%. Under the convention between State T and State S, the withholding tax rate on dividends is 10%.

The establishment of RCo’s regional platform and RCo’s subsequent investment decisions take into account the existence of tax benefits provided under State R’s extensive tax convention network. RCo deploys its capital in new investments in the region as opportunities arise. Any capital not redeployed is ultimately distributed to the Fund. RCo pays tax and files tax returns in State R.

In determining which jurisdiction to locate the intermediate vehicle, the investors considered a jurisdiction that was likely to be the most appealing to a wide group of investors. The investors took into account the existence of tax benefits provided under State R’s extensive tax convention network, and the certainty with regard to the tax treatment of interest and dividends, which is critical to investor confidence given the scale and long term nature of these investments. The intention of tax treaties includes providing benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, having regard to all facts and circumstances, it would not be reasonable to deny the benefit of the State R-State S tax treaty to RCo (or the State R resident RCo subsidiary entities).

If, due to other factors and circumstances, State S were to apply paragraph 7 to deny the benefit of the State R-State S tax treaty to RCo, State S would instead exercise its discretion to apply the State T-State S tax treaty in accordance with the principles in Article X, paragraph 8 (regardless of RCo’s fiscal transparency status in States R, S or T).

If, instead, the withholding tax rate on dividends between State T and State S was 5% (or nil as a consequence of a sovereign/domestic exemption in State S), the application of paragraph 7 would not be triggered where the Fund invests into State S via an intermediate holding entity company in State R (on the basis that the investment via State R has not generated any benefit the Fund would not have obtained if it has invested directly into State S).

The conclusions of this example would apply equally if RCo were a wholly owned subsidiary of a sovereign wealth fund of State R. Additionally, where State R’s investment platform comprises a series of separate entities (e.g. discrete sister platforms for real estate and infrastructure investments reflecting the Fund’s preferred operational and organisational structure), the principal purpose for the establishment of the regional platform will be considered with reference to the Fund’s economic and commercial nexus to the jurisdiction as a whole, rather than only on an ‘isolated’ entity-by-entity basis.”
Appendix 1: Additional non-CIV industry context

9.1 Pension Funds and SWFs investment focus

Pension systems across the world are being strained and must simultaneously meet the current cash flow demands of retirees and generate returns sufficient to fulfil their future obligations. However, pension systems are deeply underfunded, with these funding gaps leading public pension funds to allocate larger balances of their investment funds to alternative investments (which typically generate higher returns than traditional ‘fixed income’ (i.e. bonds/equities) investments). The aftermath of the financial crisis, which led to volatile and uncertain returns from ‘traditional’ investments (such as equities) has further led to a drive for institutional investors to increase their exposure to ‘illiquid’, or ‘real/alternative’ assets through non-CIV funds. The diagram below indicates the dramatic increase in the amount of capital allocated to alternative investments over the last 20 years by Pension Funds (and equally the importance of such institutional investors to the alternative investment industry).2

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2 Funds under management in the Australian Pension Fund sector are current $1.37 trillion which already exceeds the entire value of the Australian stock market (approximately $1.1 trillion as at December 2015) – further explaining the drive of Pension Funds into unlisted non-CIV assets (Infrastructure Investor, “The case for thematic infrastructure” (AMP Capital interview), March 2016, p.38)

SWFs, whilst not facing the same funding pressure as Pension Funds, are nevertheless a significant source of capital for non-CIV funds, because, like Pension Funds, they have a long-term investment horizon and can invest in assets such as Infrastructure, Private Equity and Real Estate without being compelled to exit each investment within a short timeframe. This enables SWFs to deliver on their long-term commitments to nations around the world.

The prevalence of Pension Funds as the largest investors in non-CIV funds (in infrastructure) is further demonstrated from a review of significant commitments made by global Pension Funds to non-CIV funds in the infrastructure sector during 2015, as shown in the table below4.

<table>
<thead>
<tr>
<th>LP Name</th>
<th>Fund Name</th>
<th>Fund Manager (GP)</th>
<th>Commitment Size ($m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PensionDanmark</td>
<td>Copenhagen Infrastruct Partners II</td>
<td>Copenhagen Infrastructure Partners</td>
<td>589</td>
</tr>
<tr>
<td>Washington State Investment Board</td>
<td>Global Infrastructure Partners III</td>
<td>Global Infrastructure Partners</td>
<td>500</td>
</tr>
<tr>
<td>Oregon Public Employees' Retirement System</td>
<td>Stonepeak Infrastructure Fund II</td>
<td>Stonepeak Infrastructure Partners</td>
<td>400</td>
</tr>
<tr>
<td>Oregon Public Employees' Retirement System</td>
<td>Global Infrastructure Partners III</td>
<td>Global Infrastructure Partners</td>
<td>400</td>
</tr>
<tr>
<td>New York State Common Retirement Fund</td>
<td>KKR Infrastructure Investors II</td>
<td>KKR</td>
<td>200</td>
</tr>
<tr>
<td>Maine Public Employees Retirement System</td>
<td>Stonepeak Infrastructure Fund II</td>
<td>Stonepeak Infrastructure Partners</td>
<td>150</td>
</tr>
<tr>
<td>New York Common Retirement Fund</td>
<td>Private Infrastructure Fund III</td>
<td>Patria Inversiones</td>
<td>150</td>
</tr>
<tr>
<td>Strathclyde Pension Fund</td>
<td>Temporis Capital Onshore Wind Fund</td>
<td>Temporis Capital</td>
<td>114</td>
</tr>
</tbody>
</table>

A further example of one non-CIV fund’s investor base (by type and region) is shown below.

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4 Infrastructure Investor, March 2016, p.61
9.2 Purpose and process for institutional investor investment

There are many reasons for, and a variety of ways in which, investors access real assets and the main drivers for the various investment models to demonstrate that they are not driven by treaty shopping or deferral objectives.

Keeping with the theme of non-CIV funds in Infrastructure, a report issued by The Devon County Council Pension Fund, outlining the basis of its investment into the First State European Diversified Infrastructure Fund ("EDIF"), describes well the key drivers considered by institutional investors such as Pension Funds when investing into non-CIV funds. The report describes that its key investment objectives in making a further allocation to infrastructure are (emphasis added):

- "2.1 … Improved diversification of the fund by investing in an asset class with low correlation to Gross Domestic Product (GDP). The high barriers to entry and monopolistic characteristics of many infrastructure assets mean that their financial performance is not as sensitive to the economic cycle as many other asset classes.
- Ability to enhance the Fund’s long term returns without increasing overall risk. Infrastructure can provide a high level of return, including a high cash yield. The returns targeted need to be assessed in relation to the risk of the investment, including for example the risk of changes to the regulatory system under which the business is operated, the operational risk of managing the business, and refinancing risk where there is leverage involved in financing the business.
- Ability to improve our protection from UK inflation. Inflation is a key risk in relation to pension liabilities, and infrastructure can provide mitigation against inflation risk through the agreement of contractual price increases linked to inflation."

The Report of the Country Treasurer further explains the factors considered and process undertaken by the Pension Fund in choosing to invest in the non-CIV fund:

- "2.2 … the factors to consider in choosing an investment include the ownership and experience of the firm; the leverage used; the geographical/sector focus …; target size and expected drawdown timetable; expected exit process (if any); investor base …; LGPS [Local Government Pension Scheme] experience; client service; and fees and structure.
- Over the last few months, officers have looked at a variety of different infrastructure funds, and have met with six different managers with the Fund’s Independent Advisor. The managers were asked to outline how their funds met the criteria as described in 2.1 and 2.2 above.
- From the Devon Pension Fund’s viewpoint the key attributes of an investment in the First State EDIF are:

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5 Devon Pension Fund Report of the County Treasurer, Investment and Pension Fund Committee, 13 September 2013 (http://www.devon.gov.uk/loadtrimdocument?uri=&filename=CT/13/42.CMR&r=13/WD1041&dg=Public)
A high targeted level of return – 10-12% net of fees over the long term, including a cash yield in excess of 5% per annum.

A well diversified fund with assets held and proposed in different sectors and geographical locations.

A relatively short draw down period, meaning our cash should be fully invested within a reasonable timeframe.

A long-term fund – the Fund has an initial term ending in 2024. In 2019 investors will have the option of extending the Fund to 2029 by a two thirds affirmative vote, this process to be repeated at five year intervals if extension is approved. As a long term investor, the Devon Fund can commit for long periods, and the long life of the fund will reduce the risk of a low return from the eventual sale of assets, as a larger proportion of the return is taken from the annual income yield, and the five year period for the assets to be sold is longer than the timeframe that with some of the other funds considered.

Lower fees than some of the other funds considered, including only charging fees on drawn down cash, whereas some funds charge fees on committed funds yet to be invested.”

The emphasised words further support the proposition that the objective of Pension Funds (as part of the institutional investor universe of long-term investors) when investing into non-CIV funds is to find a match for their long-term investment horizons and a specialist team capable of investing and managing their capital, and that such funds do in fact provide a regular running cash yield (rather than acting as a vehicle for tax-driven income deferral)⁶.

A recent interview with the Teacher Retirement System of Texas explored that pension fund’s infrastructure allocation and its criteria for selecting an investment manager⁷. These included:

- The manager should have an excellent track record of successful investing and deep expertise in the space.
- The fund should have a scalable approach to asset management to create value for assets and a team in place that has a track record of developing and implementing operational strategies.
- The manager should have an established network for sourcing and investing within targeted regions and a strategy for pursuing proprietary deals. It must demonstrate its access to an ample and attractive investment pipeline where it can add value and provide meaningful returns.

The interview goes on to state that “We continue to believe that … fund investment (paired with co-investment) is the best way for LPs to benefit from the asset class. Direct investment

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⁶ Further, it is common for Fund terms to contain distribution clauses which undertake that surplus cash held by the fund will be distributed to investors as and when available.
⁷ Infrastructure Investor, “Strong Performer”, March 2016, p.63
programmes require significant staffing and expertise that is beyond the ability of most public pension funds ...

This latter point is further emphasised by an interview with the First State team in which they state “Big transactions are very visible – they’re easy to spot from a distance. But infrastructure is like an iceberg: 75 percent of the market lies below the surface. You need resources to create the network, understand a sector, canvass a geography”\(^8\). These quotes indicate the importance of the fund manager’s investment origination and management team to ‘capital-rich’ but ‘resource-poor’ institutional investors looking to deploy their capital across a particular geography or asset class in the illiquid assets market.

9.3 The spectrum of models for investing into non-CIV assets

As well as addressing concerns regarding the eligibility of underlying investors in non-CIV funds to treaty benefits and deferral of income, the Devon Pension Fund report and the interviews with the Teacher Retirement System of Texas and First State illustrate three other fundamental themes that are relevant to understand in the context of the current OECD consultation:

1) The existence of a variety of fund offerings from which investors can choose – the choice available in today’s market is wide from the perspective of an institutional investor, given the increasing diversification and specialisation of funds into sub-sectors / regions. Particularly relevant within the EU rather than, say for North American-only funds, is the existence of regional funds that invest in multiple geographies throughout Europe (which, given the number of different tax regimes each such fund will invest into on behalf of its investors, require more care than any other region when developing guidance on the eligibility of such funds for treaty benefits).

The table below shows a selection of the infrastructure funds that were in the process of raising funds during 2015, that were established to invest in multiple geographies\(^9\).

Note, this is not exhaustive, nor indicative of the wider pool of funds which exist in the market which is much larger/wider. It is simply illustrative of the fact that there are a significant number of funds / investment strategies generally where the investment focus is not on any one particular country but a region as a whole, and in some cases, globally focused. In this context, we explore further below the necessity of, and practical drivers for, ‘investment platforms’, both within the organisations of such managed funds and also within the organisations of institutional investors themselves.

\(^8\) Infrastructure Investor, “First movers”, Issue 70, p.39, quote from Philippe Taillardat

\(^9\) Infrastructure Investor, “Fund Manager Guide 2015/2016”, p.31-32
2) The ‘global-local’ nature of the investment model for alternative assets – global in the sense that there is an institutional investor typically headquartered in one particular location (e.g. UK, US, Canada, Australia) with capital to deploy globally, but requiring the expertise of locally based personnel (whether part of the institutional investor’s own organisation and/or outsourced to an external intermediary / asset manager) who have the local market knowledge to identify, acquire and manage transactions and assets in the local region on behalf of the institutional investor.

Macquarie Infrastructure and Real Assets (‘MIRA’) is the world’s largest infrastructure fund manager with c.450 people around the world, sourcing, analysing, acquiring and managing portfolio investments on behalf of its investor clients. It had $103.7B in assets under management in 2015, split across multiple sectors, investing in multiple regions and with a jurisdictionally diversified investor base, as shown in the diagrams below.
3) The importance of the **specialist outsourced/’delegated’ services** provided by the teams within asset managers (GPs), also referred to as “intermediaries” because they provide specialist deal identification and execution services which enable the funds invested by the Pension Funds (LPs) to be deployed into assets held by the fund, in return for fees.

This, and the combination of the sector diversification and ‘global-local’ nature of investment into non-CIV funds gives rise to a spectrum of different investment models in the market – these depend on the size and scale of the institutional investor’s team and the asset manager’s team as
to which elements of the investment value chain are undertaken internally by the institutional investor and which are ‘delegated’ or ‘outsourced’ to be undertaken externally by the fund manager.

The different models available to institutional investors for investing into illiquid assets is depicted below\textsuperscript{10}.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{Figure3.png}
\caption{Models of Investing in Illiquid assets}
\end{figure}

Different institutional investors are at widely varying points on the spectrum in terms of their own in-house capability and the level of reliance placed on external fund managers and, as such, there is no ‘one size fits all’ model in the non-CIV funds industry.

The typical trajectory of an institutional investor seeking to access ‘alternative’ or real assets is to start with the ‘traditional delegated model’ and investing into non-CIVs fund with the expertise and relationships to make and manage the investments, and building up expertise and the relevant team over time to move gradually towards the capability for ‘direct’ investment.

Direct investing is typically a feature of the larger institutional investors with sufficient scale to do so. For strategic reasons (e.g. origination of investment opportunities), these large institutional investors also continue to simultaneously invest via managed funds. Smaller investors typically use intermediaries (i.e. external fund managers).

The tables below summarise how the investment models adopted by institutional investors have expanded over time based on the relevant expertise of such investors\textsuperscript{11}.

\begin{footnotesize}
\end{footnotesize}
Figure 36: The type investment models used by institutional investors has expanded over time

<table>
<thead>
<tr>
<th>Investment Model</th>
<th>1980s-1990s</th>
<th>2000s</th>
<th>2010s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outsource alternative investment function</td>
<td></td>
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<tr>
<td>Invest with a funds of funds</td>
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<tr>
<td>Partner with other LPs to invest in a fund</td>
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<td>Traditional fund structure</td>
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<td>Separately managed accounts</td>
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<tr>
<td>Co-investments</td>
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<tr>
<td>Joint-venture</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Direct invest</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Degree of experience with alternatives: ○ First used ■ Inexperienced □ Experienced ● Sophisticated

Source: World Economic Forum Investors Industries

Figure 39: Investor scale and direct investing approach

<table>
<thead>
<tr>
<th>Investor Segment</th>
<th>AuM</th>
<th>Typical approach to direct investing</th>
</tr>
</thead>
</table>
| “Mega” investors | Over $50BN | • Have often already built internal investing capabilities
|                  |        | • Full range of models often used, including solo direct investing |
| Very large investors | $25 to $50BN | • Overall investment strategy and governance frameworks similar to mega investor segment
|                  |        | • Lower scale means co-investing is typically the primary direct investing model used |
| Large investors   | $5 to $25BN | • Generally less developed than mega and very large investors in their approach to direct investing
|                  |        | • Greater focus on co-investing as a percentage of total direct investing than larger institutions
|                  |        | • Increasing focus on mandates where strategic investment decisions are controlled by a small highly qualified in-house team, but implementation is delegated to asset managers (and internal team does not invest directly) |
| Medium-sized investors | $1 to $5BN | • Typically use intermediaries
|                  |        | • Lack scale to cover all asset classes internally, so gain advice from external experts on most investment decisions |

Source: Oliver Wyman interviews and analysis; SIF Institute rankings 2014; PwC/Towers Watson Global 300 Investment Funds 2013.
In the context of the investment value chain outlined above, there are a wide variety of permutations and combinations within this spectrum of investment models as to how the value chain functions are shared between the investor itself and the externally appointed manager. The table below summarises the allocation of functions undertaken by the investor (‘internal’) or the manager (‘delegated’) or both (‘shared’) for the different investment models12.

![Diagram of Investment Process for Alternative Investments Relationships](image)

It is immediately apparent that the commercial structures for institutional investors and managed funds investing into illiquid assets have the hallmarks of a series of ‘alliances’ or ‘partnerships’ between the ‘ecosystem’ of investors and market ‘intermediaries’ / service providers, each undertaking the functions that they are most capable of delivering.

This context is relevant to appreciate when considering the entitlements of such investors / funds to treaty benefits, because, in practice, it is common to see these functions undertaken by either the investor, or its external service provider in a variety of locations such as the investor’s home country (from which the capital is sourced), the external service provider’s home location as well as in the jurisdictions proximate to the home country and the service provider (where the capital is managed) and the investments (where the capital is invested).

In this context, there is no single ‘right answer’ to where all of the value chain functions ‘should’ take place and the allocation of these functions is not a simple ‘bilateral’ choice between the home country and the investee / source country. Where this range of functions in fact takes place from a commercial and practical perspective can vary according to the location of the personnel of the investor and the fund manager and the investments.

It is important that the development of guidance around tests such as the Principal Purpose Test (“PPT”) (see later Example 1 in this response) does not result in an overly restrictive interpretation that does not engage with how the investment value chain works, nor on a misinformed perception of where such functions ‘should’ take place based solely on the ‘investee’ jurisdiction or the underlying investor’s ‘home country’ jurisdiction. The commercial reality is more sophisticated than that when considering the ‘platforms’ through which such investments are pooled, deployed and managed on a day to day basis.

The diagram below depicts the investment value chain for illiquid assets of non-CIV fund investors13.

It is clear from the above that a large number of steps are involved in the typical process used by institutions and managed funds to invest in illiquid assets. Almost all institutions outsource one or more of these steps to specialist providers, most often in the region proximate to either or both of the investment destination and the jurisdiction of the specialist service provider.

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Appendix 2: Regulatory frameworks

The consultation raises questions regarding what type of regulatory frameworks apply to non-CIV funds. The table below indicates the wide range of regulations that affect the non-CIV investment industry. As can be seen, fund managers (i.e. asset managers) are subject to a wide range of investment management regulation such as FATCA and AIFMD.

<table>
<thead>
<tr>
<th>Regulatory reform</th>
<th>Legislative region</th>
<th>Banks</th>
<th>Asset managers</th>
<th>Insurance companies</th>
<th>Pension funds</th>
<th>High-net worth/Retail investors</th>
<th>Hedge funds</th>
<th>Private equity</th>
<th>Venture capital</th>
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<td>Dodd-Frank Wall Street Reform and Consumer Protection Act, (Dodd-Frank)</td>
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<tr>
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<td>Undertakings For The Collective Investment of Transferable Securities V (UCITS V)</td>
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<td>Alternative Investment Fund Managers Directive (AIFMD)</td>
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<td>European Commission’s Likanian proposals (Likanian proposals)</td>
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<td>Solvency II Directive (Solvency II)</td>
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<td>European Market Infrastructure Regulation (EMIR)</td>
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<td>Packaged Retail Investment Products (PRIPS)</td>
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<td>International Financial Reporting Standards (IFRS)</td>
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<td>Retail Distribution Review (RDR)</td>
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Source: World Economic Forum Investors Industries

Primary target ☐ Also affected ☐
11 Appendix 3: Addressing the challenges of adopting a ‘look-through’ approach

Although in the context of the LOB, the OECD’s Discussion Draft questions related to the identification of treaty-shopping are equally as applicable in the context of examining how a look-through approach may operate in practice. We set out below, in the context of Example 5, our responses to specific questions raised in the Discussion Draft:

Response to Question 7: Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits or the treaties concluded by that State?

As becomes clear from the multi-geography features of non-CIV investments outlined above, particularly in the case of European and Global funds, the transparent entity approach outlined in the consultation is not likely to be workable.

We consider this is where US-only focused funds currently would have a material tax advantage over regionally focused funds, particularly European funds, if the PPT rule is not sensibly interpreted.

Whilst the US approach to treaty entitlements is based on the LOB provision, in practice, treaty entitlement is not an issue for institutional investors or managed funds investing into the US. This is a feature of (1) the ‘single country’ nature of US-focused funds; and (2) the US check-the-box regime – neither of which are relevant to European or global funds.

As the US tax regime enables any form of vehicle to be ‘switched on or off’ in terms of being fiscally transparent or opaque, and given the underlying investment is only ever a one-country US investment, in practice, investors are able to establish investment structures where the ‘platform’ or ‘co-investment’ vehicles used are able to be (or switched) to tax flow-through vehicles enabling each underlying investor to claim US tax treaty benefits based on its underlying home country entitlement. This is not overly-complex from an administrative perspective because the ‘permutations’ are often ‘single-digit’ in terms of say 5-10 jurisdictions of investors and different investor types meaning only that number of different tax treaty outcomes by investor. Further, sovereign immunity and relaxations of US ‘land-rich’ taxes (FIRPTA) mean that certain investors are able to mitigate certain US withholding taxes entirely.

Therefore, whilst there may be concerns which we understand may have been voiced in the context of interpretation of the LOB provision etc., in the context of application to non-CIV funds, we consider that many institutional investors and managed funds are able to structure US inbound alternative investments with limited uncertainty over the application of their relevant bilateral US tax treaty irrespective of the use of intermediary platform vehicles.
However, the situation is different when considering investment by the same investors into Europe. This must be considered from a European perspective, given the global investor base, as such investors do consider not just how to deploy their capital, but whether to deploy it at all – and if a European interpretation of the PPT becomes overly uncertain or prohibitive to investment, this could have the effect of skewing investment away from Europe and towards the US where equivalent uncertainties do not exist in the same way.

As Europe is a conglomeration of 20+ source countries, each with a different tax regime, and none of which have the equivalent of a ‘check-the-box’ regime, it would be extremely difficult without material changes to tax regimes (or implementation of the ‘global streaming fund’ concept) to apply double tax treaties on a source country / underlying investor bilateral basis on the basis of fiscal transparency.

- Firstly, even if this was possible under source country tax regimes, the permutations and bilateral treaties that would need to be considered would greatly exceed the 5-10 example for a US-focused fund. With say 20 European source countries and 5-10 investor types, the bilateral treaty permutations would range from 100 to 200 rendering the administration of such an approach too complex administratively.
- It is important to note that underlying investors can be identified, but the effect of pushing the burden of managing bilateral treaty outcomes across e.g. 100+ scenarios for an EU investing fund with globally diversified investors onto managed funds is that it would become cost prohibitive and could easily dissuade institutional investors from investing into managed funds at all, and risk ‘disintermediating’ the industry – separating capital from expertise and reducing the flow of investment into areas such as European infrastructure development.
- Secondly, even if it could be administered cost efficiently, the likelihood of 20 European source countries having a common view on what is a fiscally transparent vehicle under their own tax regime is very low. It is inevitable that some source countries would view a vehicle as fiscally transparent while others would view the same vehicle as fiscally opaque. Trusts, and even partnerships, are a common area of uncertainty given Europe’s mix of not only tax but legal regimes.
- One only has to look at the recent Anson case\textsuperscript{14} to see the complexity around entity classification in the UK (in the case of a Delaware LLC) – extrapolating that across Europe would likely give rise to both uncertainty and complexity for investors and fund managers as no one vehicle will receive the same fiscal entity classification under each relevant source country or home country tax regime.

In summary, the focus of the transparency approach outlined in the consultation seems to be grounded in the idea that it is desirable to give effect to bilateral treaties at the level of the

underlying investors as a way of seeking comfort that non-CIV funds are not being used for treaty shopping or tax deferral purposes. However, other than for countries such as the US where the single-country nature and local tax regime favours that approach, we consider this to be a misinformed desire in the context of regional, particularly European, focused funds as it completely bypasses the commercial relevance of the platform jurisdiction and extends exponentially the range of bilateral treaties that would need to be considered.

This cannot be a proportionate or effective response to the concerns expressed by governments, particularly in light of the comments made earlier that most underlying investors being Pension Funds and SWFs are in any case entitled to treaty benefits in their own right from such source countries and tax exempt (with no incentive for tax deferral) in their home jurisdictions.

Thus, where the investor base of a managed fund / platform can be established (as is the case with managed funds today given ‘Know-Your-Client’, Anti Money Laundering, FATCA requirements etc.), and given the criteria for why such investors invest into non-CIV funds has been articulated in more detail earlier (i.e. motivated by access to expertise of the manager and a transaction pipeline rather than tax-driven) a more proportionate response would be to attach that ‘bona fide’ institutional ‘eligibility’ to the relevant fund and enable it to administer treaty entitlements between the source countries and the investment platform jurisdiction on a bilateral basis between those jurisdictions.

Response to Question 14: How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

The ease or difficulty of obtaining information about ultimate beneficial ownership depends on the facts. If an institutional investor owns an interest in an investment indirectly through a wholly owned subsidiary, identifying the institutional investor should be easy, because the wholly owned subsidiary can provide the required documentation. Ultimately, almost all such instances, there will be a method to identity the ultimate beneficial owners at the level in which documentation is kept. Similarly, in so-called ‘club’ deals with a limited number of investors, institutional investors may invest directly or through wholly owned subsidiaries, in which case identification is easy.

In some cases, institutional investors may invest through partnerships, co-investment vehicles or managed funds. In this case, identification can present some additional challenges, because the investors may need to agree to provide the necessary documentation, and different investors may treat the investment vehicle differently. These challenges can be overcome, at least prospectively, with clear guidance as to what documentation is required for investors to pass up through the investment entity.

Based on our understanding of the funds industry, it should be possible for the majority of funds to identify their ultimate investors. For example, in the above situation:
Consortium Co is likely to be able to identify and document PF1 and PF2 (which accounts for 90% of investors); and

Whilst practically more burdensome, identification of the underlying investors in Infra Fund (the remaining 10% of investors) should be achievable if required.

We reiterate the earlier point that, the commercial reality is that the activities of the value chain undertaken at the level of the fund / investor intermediary platform are ‘real’ functions requiring day to day involvement and that this should be sufficient to grant treaty benefits on a bilateral basis between source countries and the platform jurisdiction, rather than ‘disrespecting’ the platform level activities and defaulting to a multitude of source country / home country bilateral treaties as the primary approach. The ‘look through’ approach can in our view serve as the ‘fall back’ / secondary approach should a (well-designed) PPT be failed at the level of the intermediary, however, we consider it more practicable and low-risk from a treaty shopping / deferral perspective to adopt a primary approach of enabling a bona fide and legitimate platform to access treaty benefits based on its own eligibility.

Response to Question 15: What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example, under anti-money laundering, FATCA or common reporting standard rules)?

Many funds use one or a number of the following processes for identifying investors:

1) Requiring all investors to provide a W8-BEN (or equivalent) form as part of completing the private placement memorandum. Failure to do so would result in consequences to the investor, such as being subject to the highest rates of US WHT rates and/or being separated from compliant investors so as to remove the risk of being tainted by recalcitrant investors;

2) Use of the QI or TRACE regime, where the onus is on the top level investor to demonstrate an entitlement to treaty relief or, if it is not prepared to do so, forego its treaty entitlements and be subject to domestic withholding tax rates;

3) For FATCA and US withholding tax purposes, US tax forms are collected from investors;

4) Use of AML and CRS, which look to the immediate interest holder and in many cases identify the Controlling Persons behind that interest holder (including residence); and

5) Requirements to comply with Know Your Customer (“KYC”) verification rules prior to accepting investors into the fund, which may require the following documentation be produced per investor:
   (a) Investor declarations;
   (b) Certificate/articles of incorporation;
   (c) List of directors/authorised signatories (and identification for each);
   (d) List of shareholders;
   (e) Details around the origin of funds; and
   (f) Latest audited financial reports.
For the purposes of determining the treaty benefit eligibility of underlying investors, the above processes could be adapted to include a method of self-certification by the underlying beneficial owners (possibly similar to the W8-BEN form), which would be collected by the fund manager and made available to the relevant tax authority. Further consideration would need to be given to how many and which countries self-certification would apply to.

In addition, whilst acknowledging the practical and political challenges of such an approach, we also consider there to be value in exploring the concept of a global streaming fund, whereby the fund itself is responsible for withholding based on its investor characteristics. There have been a number of proposals around possibly investor identification methodologies. It is clear that most workable solutions involve additional requirements for both fund managers and investors. In our view, such additional costs and administrative burdens may be necessary to mitigate the risk of declining capital being invested into funds.

Response to Question 16: Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payers that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

A number of funds have provided the following feedback in relation to this question (mostly US specific):

1) Generally, this information is sufficient for the fund to identify the ultimate investors – funds can usually determine the ultimate jurisdiction in which investors are located;
2) With respect to US investments, reliance is placed on investors to provide accurate W8-BEN forms. In some circumstances, investors provide their investment details in order for the fund to determine the reasonableness of their W8-BEN assertions;
3) The W8-BEN forms are provided under the penalty of penalties or perjury and are therefore relied upon by the fund as accurate;
4) Should an investor located in a non-treaty country assert that they are entitled to US treaty benefits, the fund questions the basis of that claim (although the investor would not be audited); and
5) For funds that invest in assets globally, it is not always practical to request a form of declaration from investors on their treaty status across all investment jurisdictions (which may change from time to time, particularly in an open-ended fund context).

Response to Question 20: As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt of taxed on a current basis?
Conceptually, both qualification for treaty benefits and tax exemption or current taxation (inclusion) should be tested at the level of the investor claiming entitlement to treaty benefits. In other words, the investor claiming to be eligible for treaty benefits would also be the investor that would need to be currently taxed or tax exempt.
Tax Treaties, Transfer Pricing and
Financial Transactions Division
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22 April 2016

By email: taxtreaties@oecd.org

Dear Sirs

BEPS Action 6: Treaty Entitlement of Non-CIV Funds (public discussion draft released on 24 March 2016 (the "Draft"))

Further to our letters of 30 October 2014, 7 January 2015 and 17 June 2015 we are writing to you to express our concerns that the most recent proposals by the OECD, as set out in the Draft, will likely still prevent most non-CIV debt funds from accessing treaty benefits. (We use the term debt funds, as we have previously, to refer to securitisations, capital markets SPVs, CLOs and funds established to advance or acquire loans to individual or corporate borrowers.)

We are disappointed that our comments relating to the impact of the implementation of the LOB rule on treaty benefits for debt funds as outlined in our previous letters do not appear to have been considered by the working party. There is no recognition in the discussion draft of the diversity of non-CIVs, and no discussion at all of the fundamental incompatibility between the proposed LOB and securitisation issuers and other funds and special purposes vehicles funded by listed and cleared bonds/debt securities (many of which are systemically important to the financial system). To reiterate the point from our previous recommendations: it is simply not possible, without very significant changes in the clearing systems' internal workings and legal/regulatory frameworks, for such an entity to know who its bondholders are. The proposed LOB would therefore exclude such entities from treaty benefits. If that is indeed the intention then it would be helpful to say so outright, although it would be a surprising direction to take at a time when there is a general desire amongst policymakers to promote securitisation (see, for example, the EU's "capital markets union" project). If, on the other hand, that is not the intention then we would suggest that further work is required.

As noted by others, there are also significant practical difficulties for other non-CIVs, such as private funds, which could in principle identify their beneficial owners, but will have great practical difficulties in doing so.

In response to your questions:

1. **The threshold for determining a fund is "widely held"**

   Given the difficulty of establishing the identity of investors from time-to-time, any test would have to be assessed by reference to the intention of the parties and/or the manner in which the original marketing of the fund was undertaken. The "genuine diversity of ownership condition" in existing UK tax legislation may be an appropriate model.

2. **Appropriate regulatory frameworks**

   Given that the great majority of the debt funds which are the subject of this letter are aimed at institutional investors, and therefore not regulated, we make no comment on this question.
3. How would treaty-shopping concerns be addressed

We have yet to see any evidence presented that debt funds are used for treaty shopping in the manner described. Given that investors almost never have control over the investments made by such funds, they seem quite unsuitable for the purpose. If this is the rationale for generally denying treaty relief to non-CIVs then we would expect it to be supposed by an evidence base – is that the case?

If there is evidence that non-CIVs are used for treaty shopping then the challenge is to formulate an approach that prevents treaty shopping whilst not penalising the those non-CIVs (likely the great majority) that are not involved in treaty shopping. The TRACE Project, or a development of it, seems to most likely candidate.

4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution?

The answer to this question will naturally vary from jurisdiction to jurisdiction, although we would note that pension funds and analogous entities are typically exempt from tax, and banks, insurance companies and similar entities are typically taxed on an accounting fair value or accruals basis (and at the point they receive a cash distribution).

If particular investors in a particular jurisdiction are perceived to be obtaining an unfair tax result from investing in a debt fund then the answer is for that jurisdiction to change its tax rules. We do not see the justification for changing the tax position of the debt fund as a whole.

5. What features could make a non-CIV exception more palatable to those States supporting an LOB?

This question cannot be answered in any detail without an understanding of why those States consider that non-CIVs are used as vehicles for treaty shopping. A pragmatic approach would be to introduce a non-CIV exception as a stop-gap whilst TRACE is developed and implemented.

6. Cascading taxes

Debt funds constituted as SPVs issuing debt securities/bonds to the capital markets generally invest directly. Debt funds constituted as fiscally transparent entities generally invest using intermediate SPVs to avoid the practical difficulty of each investor in the debt having to individually claim treaty relief.

7. Transparent entities and practical difficulties

Please see our initial comments above. These issues were identified by the TRACE Project, and appropriate recommendations made for mitigating them. It is, therefore, unfortunate that (as far as we are aware) there has been no progress since 2013 in implementing TRACE.

8. Institutional investors

The term has no formal definition of which we are aware, but includes pension funds, insurance companies, banks, other funds and others. Some will be taxable; some will be exempt. Such entities generally acquire investments in the ordinary course of their business and, when investing in a debt fund, will be doing so solely for commercial reasons.

9. Categories of non-CIV

Please see above.

10. Anti-abuse rules

For the reasons noted above, rules focussed on the identity of investors are not practicable. A properly formulated "genuine diversity of ownership" test would eliminate the need for a specific anti-avoidance rule.
11. Bona fide investment objective

It is unclear how a fund that satisfies a genuine diversity of ownership test could do so without also having a bona fide investment objective (otherwise, why would third parties be investing in it?). We would hesitate before defining what a bona fide investment objective is, given the variety of funds and their different investment strategies.

12. Diverse investor base

As noted above, we suggest a "genuine diversity of ownership" test.

13. Stability of investor base in a non-CIV

There is no one answer to this question. Some funds, for example those investing in long term project finance transactions, would expect to attract pension funds investing for perhaps thirty years. Others, for example securitisations with AA or AAA rated bonds, would be very liquid with frequent trading. Some securitisations may have multiple tranches of bonds, with some held for the long term and others very liquid.

14-16. Inability to determine identity of investors

It is, as noted in our previous representations, fundamental to the way many systemically important classes of non-CIVs are established that they cannot determine the identity of their investors. If it is desired to "look through" cleared bonds then fundamental changes to clearing systems, and their legal/regulatory frameworks, would be required. We have no objection to such changes; however we cannot understand how the need for such changes can simply be ignored.

This is recognised by FATCA and CRS, which ensure reporting by withholding agents (in the case of FATCA) or the last financial institution in the payment chain (in the case of CRS). These regimes were carefully designed so that they achieved their objectives without placing impracticable or impossible identification burdens on non-CIVs.

17-19. Treaty shopping

In the absence of evidence that non-CIVs are used for treaty shopping we do not understand the objective of these questions. As noted above, it is impracticable or impossible for many non-CIVs to determine the identity of their investors.

20-21. Prevention of deferral

Please see our answers to 4 above.

22. Derivative benefits test

A derivative benefits test is plainly of no assistance to a debt fund that is not in a position to identify its investors.

23. Substantial connection test

We would first make the point that a rule that requires an entity to appoint an investment manager in its own jurisdiction is likely to be contrary to the freedom of establishment under EU law.

In relation to the treaty-shopping and tax deferral questions, we refer to our answers above.

24. "Global streamed fund" regime

This proposal seems dependent upon identification of investors which, for the reasons noted above, is often not possible.
25. **Examples for the commentary on the PPT rule**

We would suggest the following as examples of legitimate arrangements commonly entered into by non-CIV funds:

(a) A private debt fund, structured as an English limited partnership with a Luxembourg corporate subsidiary, acquires loans to borrowers in various jurisdictions. The investors in the debt fund are typically institutional investors such as insurance companies and pension funds. Some of the investors may be "funds of funds"; their investors are also likely to be institutional investors, but the underlying debt fund may not have visibility on the identity of the investors in the fund of funds;

(b) A bank securitises a portfolio of loans advanced to borrowers in multiple jurisdictions. The securitisation is structured as a UK public limited company SPV held by a trust for the benefit of various charities and public bodies. The SPV funds its purchase of the underlying loans by issuing bonds to investors in the UK, Europe and worldwide. The bonds are cleared through Euroclear and Clearstream. The likelihood is that the bonds are held by institutional investors (and the regulatory framework may prevent them from being marketed to retail investors) but the way in which clearance systems operate means that the SPV has no way of determining who the bondholders are. The bonds may be tranched, with some tranches very liquid and others held to maturity.

(c) An investment manager establishes a CLO, structured as an Irish public limited company SPV held by a trust for the benefit of various charities and public bodies. The SPV appoints the investment manager's affiliates in France, the US and the UK to acquire and manage loans (in consideration for an arm's length fee). The acquisition of loans is funded by the SPV issuing various tranches of bonds to investors. The bonds are cleared through Euroclear and Clearstream (with the consequences described above).

26. **Concerns in relations to conduits and the PPT**

The principal purposes of the non-CIV examples above, indeed the other non-CIV structures of which we are aware, are entirely commercial. Hence we do not believe structures of this kind are subject to the PPT in its current form.

27. **"Special tax regime" rule**

In our representation of 17 June 2015 we suggested that the "special tax regime" definition, as drafted, covers a number of securitisation tax regimes established by EU jurisdictions. We would restate that concern.

We would hope that the issues raised in this letter, and our previous recommendations, can be discussed by the working group. It would be most unfortunate if systemically important entities are excluded from the international loan market without proper consideration being given to whether this is a desirable result.

Please do not hesitate to contact us if you require further information in relation to any of the above.

Yours sincerely,

Clare Dawson
Chief Executive
Dear Sir/Madam

RE: OECD Public Discussion Draft – Treaty Entitlement of Non-CIVs

Thank you for the opportunity to respond once again in relation to this issue. M&G\(^1\) welcomes the attention that has been given to the funds industry in relation to Action 6 and set out our further comments for your consideration.

In our view a non-CIV fund has very similar objectives to a CIV fund, and is designed to achieve tax neutrality. We would like to refer back to our position stated in our response to the discussion draft in May 2015. To summarise, we suggested that:

(i) Non-CIVs which are widely held and professionally managed are unlikely to have been set up for an investor to abuse tax treaties. This is primarily due to the fact that an investor will have no control over the investment decisions.

(ii) The nature and form of the entity should be respected and only in circumstances where the entity is not eligible for treaty benefits in its own right, will it be appropriate to look through to apply the equivalent beneficiaries test.

Given this, we would like to emphasise the need to properly define the types of funds which should be able to benefit from tax treaties and specifically provide that non-CIVs should be subject to the same considerations as CIVs for the purposes of the limitation of benefits clause.

It is noted that in the 2010 Report, CIVs have been specifically defined as ‘widely-held, hold a diversified portfolio of securities and are subject to investor protection regulation’, but the report also goes on to mention that other types of funds were not considered at the time. We therefore consider it is appropriate to revisit the types of funds which should qualify for treaty benefits and suggest the definition for treaty eligible funds is expanded beyond the 2010 CIV definition for the purposes of Action 6. Whilst we have set out a proposed definition below, we suggest the matter is best decided by contracting parties of a tax treaty.

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\(^1\) M&G is the UK and European fund management business of the international financial services group Prudential plc. It has over £245 billion of funds under management, making it one of the largest UK fund managers. M&G manages a range of different fund types in the three major fund jurisdictions in Europe, which include UK Open Ended Investment Companies, UK partnerships, Irish Variable Capital Investment Companies, Irish Common Contractual Funds, Luxembourg Société d’investissement à Capital Variables and Fonds commun de placements.
For the purposes of this letter, the term ‘CIV’ is as per the definition in the 2010 Report.

**CIV definition**

In a similar way to CIVs, many non-CIVs are designed to provide a cost efficient, pooling vehicle to facilitate investment and savings. Often the types of investment strategies and assets will mean that the funds cannot fall within the CIV definition, however, in substance the purpose of investing in these funds is the same as for CIVs. In particular, the principal reason an investor would choose to invest in our non-CIVs is to benefit from the professional investment expertise at M&G and to access investments which they may otherwise be prohibited from investing in, and not for tax reasons. As an investment manager, we are uniquely placed to identify potential investment opportunities and we are able to deploy capital for the benefit of investors. Many of these opportunities are often private, or may be too large and therefore pose too much of a risk for a single investor. Consequently, M&G non-CIV funds actively contribute to the liquidity of securities markets, invest in private debt financing where traditional financial institutions are not able to lend, hold infrastructure assets and direct real estate which includes residential property and social housing.

Our proposal is that the current CIV definition is expanded to include funds that are widely held, professionally managed, hold a diversified portfolio of investments (not limited to securities) and invest in assets for medium/long term. Given the potential uncertainties around defining specifically what may or may not be included, we suggest that the ultimate determination of eligible funds is a matter for contracting parties of a tax treaty.

Whilst certain assets may be held within special purpose vehicles, we suggest that there should be no requirement to look through an entity with sufficient economic activity and substance. But where substance is deemed insufficient, the fact that the entity is held within a fund structure (as defined above) should be sufficient for the entity to obtain treaty benefits. The requirement for a CIV to be regulated is also not essential as sophisticated professional investors do not need to invest in a regulated fund. It is understood that one of OECD’s concerns is the abuse of treaties by funds but we suggest that the most important consideration to address is the investment strategy of the fund. In particular, the need to distinguish between a fund which makes and holds a diversified portfolio of investments with a buy-hold, medium/long term strategy (relative to that asset class), compared to a fund which frequently buys assets over a shorter time period with the sole object of re-selling at a profit (considered in the UK as ‘trading’ rather than ‘investing’).

Thank you for the opportunity to provide comment in relation to this important issue. If you would like to discuss any of our comments please do not hesitate to contact me at Malcolm.richardson@mandg.co.uk or on +44 (0) 207 548 2316.

Yours faithfully

Malcolm Richardson
Head of Tax, M&G Investments
Specific responses to the consultation

Treaty benefits to non-CIVs

1. What would be the threshold for determining that a fund is ‘widely held’ for the purposes of such a proposal?

As indicated in our earlier submissions, we strongly believe that ‘widely held’ entities should not be considered as vehicles used for treaty shopping. Principally, where the entity has appointed a professional investment manager which acts in an independent capacity, the investors do not have the ability to select or influence the investment decisions and by definition should not be considered as using the vehicle for treaty shopping purposes.

We suggest that the UK concept of the ‘widely held’ test is adopted. This is a well understood concept and is based on the following:

“A fund is ‘widely held’ if either no majority interest in the fund is ultimately held by five or fewer persons and persons connected with them, or if no interest of more than 20% is held by a person and persons connected with him.”

This legislation was designed for the UK Investment Management Exemption which provides clarity on when a non-UK investment fund is not considered to be subject to UK taxation as a result of the activities of the investment manager. Consequently, we consider that the test would be appropriate for determining the independent nature of investors and therefore support the fact that they cannot be using a vehicle for treaty abuse. From a fund perspective, the 20% test would be more manageable and straightforward to apply. In any event, there should be a period of time for the fund to build up capacity before any restrictions are applied.

Where the holder is a pension scheme, life insurance company, or another fund, then the widely held test should be applied at that level and the pensioners, policyholders, unitholders counted. This will prevent such bodies being precluded from holding a significant interest in non-CIVs for the benefit of the ultimate beneficiaries. The approach taken by Australian authorities provides that certain superannuation funds, life insurance companies, fund of funds are deemed to have 50 members and this is considered for the purpose of the Australian widely held test.

There is an argument that where an entity has a defined strategy of investing in a particular market, that an investor who does not ordinarily benefit from such a tax treaty would be able to gain benefits. However, we suggest that such a benefit should be considered equivalent to the other benefits of investing in a fund – that is, benefits of a diversified portfolio, reduced transaction costs and dealing costs due to economies of scale compared to the investor investing directly. Accordingly, treaty access is not abusive.

2. What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

As mentioned above, we do not consider there to be a need to have a regulatory requirement as an asset test as well as a widely held test would be sufficient to ensure that treaties are not being abused.

3. Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?
Arguably, investment into a particular country has broader economic benefits. As noted above, investors in a professionally managed fund will not have control over the underlying investment decisions, and even if the fund had a very specific investment strategy, the tax benefits to an individual investor of a widely held fund would be akin to the overall benefits of investing in a fund.

4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

Investors are subject to tax in the jurisdiction where they are tax resident and certain countries (UK, Austria, Germany, Switzerland), investor reporting is required. In some circumstances, investors are taxed on a mark to market basis.

There is typically no mandatory distribution requirement as the ability to do this will depend on the type of assets the fund holds. However, a fund will typically distribute returns in order to avoid a cash drag on the fund performance. Accordingly, there is little risk of tax deferral.

Non-CIVs set up as transparent entities

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

We are pleased with the new provision on transparent entities which is in line with the comments in our response to the discussion draft in January 2015, but we do not support comments suggesting that a non-CIV should be able to elect to be treated as fiscally transparent.

Whilst we acknowledge that a fully transparent entity needs to provide all relevant documentation, the administrative challenges are often commensurate with the higher number of investors from different jurisdictions and the number of investment markets involved. The question becomes more of whether an investment market respects the transparency of the entity involved and the administrative challenges are not necessarily complicated for all types of investors/investment strategies.

In our experience, it is typically tax exempt pension schemes which are investors in fully transparent vehicles as they are afforded full tax exemption on all income and gains under a number of tax treaties, which is in line with the treatment they would receive if they had invested directly. Over time it has become clearer which markets are willing to accept the transparency of an entity and the information required from investors. Accordingly, transparent products have been designed with this in mind and any required information obtained at an early stage.

Derivative benefits rule

8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the
Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

We consider that a derivatives benefits rule should only apply in circumstances where the LOB clause applies. As noted above, the definition of CIV should be expanded in which case the LOB should not be applicable in general to certain funds.

For this question, we would consider ‘institutional investors’ to be pension schemes, supranational or sovereign wealth funds. These types of investors are tax exempt or benefit from special tax regimes which a non-CIV fund would seek to preserve. For these types of investors, the purpose of investing in funds is certainly not for treaty shopping purposes.

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

As noted in our general comments, the characteristics of a fund should be considered for the purposes of defining a CIV. We suggest the current definition should be expanded to include funds that are widely held, professionally managed, hold a diversified portfolio of investments (not limited to securities) and invest in assets for medium/long term. Widely held should be defined as in our response to Q1.

10. Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

See comments on expanded CIV definition

12. How would it be determined that a fund is ‘marketed to a diverse investor base’ for the purpose of paragraph 17 above.

The UK has a concept of ‘genuine diversity of ownership’ which could be adopted. This broadly consists of the following 3 conditions which must be met throughout the account period:

(i) Fund documents include a commitment to target categories of investors in a public and binding way
(ii) Terms and conditions of the fund not set in a way to limit investment to a select group within the stated categories of investors
(iii) Marketing, providing information and selling units – despite meeting the conditions above, the fund must act in a way which supports the statements made.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

Under the current definition of non-CIV funds, M&G funds include private debt, infrastructure and real estate funds. We hold KYC information and have validly completed self certifications from investors which inform us of their tax residency and tax status. Whilst such information may be useful to determine derivative benefits, we are strongly of the view that the legal form of fund vehicles is respected and the proposed definition of a CIV is sufficient to permit the treaty eligibility of funds, without the risk of the funds being used for treaty abuse.

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

As noted above, by having a widely held requirement of the fund, the fund would be equivalent to a listed company. Investors would not have a significant enough of a holding to be able to derive material benefits from
treaty access alone and any benefit should be attributed to general advantages of investing in a professionally managed and diversified fund.

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

The benefit of a treaty typically reduces a withholding tax rate on interest/dividends by 15%, capital gains is typically attributed to the country where the investor is resident.

Assuming a 5% gross income yield and a $1bn fund. On a $200m investment, the annual treaty benefit would result in the investor receiving $10m compared to $8.5m i.e. 75bps difference. However, the investor would typically need to pay 150-250bps in management fees and performance fees.

Accordingly, a treaty advantage is helpful but by no means an incentive to invest specifically in a fund in order to gain this benefit. Further, if the fund is very large, it is even more unlikely that the investor would have been able to access the same type of investments themselves given the lack of diversification of risk.

22. Are there practicable ways to design a “substantial connection” approach that would not raise the treaty shopping and tax deferral concerns described in paragraph 21 above?

We support the ‘substantial connection’ approach as it aligns with the more general concept of respecting the legal form of the entity claiming treaty benefits.

We agree with the suggestions for the funds to maintain sufficient substance. In addition to this, to address the concerns of the Working Party, we would suggest the following additional criteria.

- Investors are subject to tax (under the laws of their territory of residence) on payments received from the fund, without any reduction.
- The local tax authorities are notified of their existence and the entity is itself taxable on profits.
- Transactions between the fund and investors/investments are all conducted at arm’s length.

The purpose of these additional conditions would mean that there is reduced risk of double non-taxation as the investor would need to confirm they are subject to tax, the tax authorities would be aware of any risk of potential abuse of the vehicle for treaty shopping purposes, and the fund would be acting independently with sufficient substance.
Dear Sir or Madam

Treaty Entitlement of Non-CIV Funds

We welcome the opportunity to comment on the discussion draft Treaty Entitlement of Non-CIV Funds issued on 24 March 2016 (the “Discussion Draft”).

Matheson is an Irish law firm and our primary focus is on serving the Irish legal and tax needs of Irish and international companies and financial institutions doing business in and from Ireland. Our clients include over half of the Fortune 100 companies. We also advise seven of the top ten global technology companies and over half of the world’s 50 largest banks. We are headquartered in Dublin and also have offices in London, New York and Palo Alto. More than 650 people work across our four offices, including 75 partners and tax principals and over 400 legal and tax professionals.

In this letter, the “2010 Report” refers to the OECD Report The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles. “LOB” refers to the limitation of benefits clause proposed in the Report. “PPT” refers to the principal purposes test proposed in the Report. “CIV” refers to collective investment vehicles that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established.

Comments in this letter are made solely on our own behalf.

1 General Comment

Throughout the Action 6 consultation process, we have raised a concern that insufficient attention has been given to the position of treaty access for securitisation companies. As part of the Capital Markets Union (the “CMU”), the European Commission (the “Commission”) has been seeking to revive the European securitisation market. Since the financial crisis...
European securitisation markets have remained subdued. The Commission recognises that securitisation “facilitates access to a greater range of investors, thereby increasing liquidity and freeing up capital from the banks for new lending.” The Commission anticipates that if the European securitisation market can be revived, this new lending would benefit the real economy and in particular SMEs. If securitisation companies are denied treaty relief, it will inhibit a revival in the European securitisation market.

A securitisation transaction generally involves the sale of financial assets to a securitisation company. The securitisation company will generally be established as a bankruptcy remote company with nominal share capital. The securitisation company fully funds the acquisition by issuing debt securities to investors. The debt securities may be listed and are often issued into a clearing system. When the securities are issued into a clearing system, the securitisation company is not permitted to know who holds the securities.

The securitisation transaction benefits the investors by giving them exposure to assets that they might otherwise not be able to invest in. It benefits the originator of the financial assets by “freeing” part of their capital that was set aside to cover the risk in the financial assets sold, thereby permitting the originator to generate new lending, which in turn benefits the broader economy.

The work under Action 6 (and in particular the work on the LOB) has not, to date, addressed the question of treaty access for securitisation companies. The LOB provision is not workable for securitisation companies that issue debt securities into clearing systems. We strongly recommend Working Party 1 to consider the on-going work of the Commission on the CMU and to consider the question of treaty access for securitisation companies. If no solution can be proposed at this point, securitisation companies should not be denied treaty benefit under the new proposals until a workable solution has been agreed.

2 Regulated and/or widely-held non-CIV funds

Question 1: What would be the threshold for determining that a fund is “widely held” for the purposes of such a proposal?

The widely-held concept was included repeatedly in the 2010 Report. It is clear from that report that there is some consensus that one of the features of CIVs entitled to claim treaty relief is that they are widely-held. The rationale underpinning this approach is that it is less likely that widely-held CIVs can be manipulated for treaty shopping. We agree with that rationale. This widely-held feature can also be a feature of non-CIV funds and where it exists should be similarly taken as an indicator that it is unlikely that the entity can be manipulated for treaty shopping.

The approach adopted in the 2010 Report might equally be adopted for non-CIV funds. If any widely-held threshold is agreed for non-CIV funds, it should be no higher than that applicable to CIVs.

In considering whether any fund is widely-held, it is important to take account of indirect as well as direct control. For example, if 100% of the interests in a non-CIV fund are held by a pension fund that itself is widely-held, the non-CIV fund should equally be treated as widely-held.
Question 2: What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements in paragraph 16 of the 2010 CIV report (i.e., “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g., “know your customer” rules)?

Similar to the use of the widely-held concept, the term regulated was frequently used in the 2010 Report. Although the 2010 Report outlined some of the typical regulatory requirements applicable to CIVs, it did not seek to strictly identify a set of required features. The same approach could also be adopted for non-CIV funds. We expect that no higher level of regulation will be required for non-CIV funds than the level currently required of CIVs.

Regulatory regimes by their nature differ from jurisdiction to jurisdiction. This must be recognised if Working Party 1 considers that a regulatory threshold should be agreed for the purposes of determining when non-CIV funds are entitled to claim treaty relief. A practical approach might be to agree a number of indicators of appropriate regulation. Entities that meet a majority of those indicators should be regarded as sufficiently regulated. In addition to those features identified in question 2, the following indicators could be considered:

- the entity is required to deliver a prospectus to investors disclosing the risks associated with the investment;
- the entity is subject to supervision by a national authority;
- only entities that are themselves regulated can be appointed as principal service providers to the entity (e.g., investment managers, custodians, depositaries);
- the entity reports information (other than its audited accounts and tax returns) regarding its business to a national authority;
- the directors of the entity have been approved by a national authority.

Question 3: Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

If the fund is widely-held, it is hard to envisage the primary purpose of the fund being to obtain treaty benefit for investors that are not otherwise entitled to such benefit. The rationale for treating publicly listed entities as qualified persons under the LOB is not dissimilar to the position that should apply for widely-held non-CIV funds. It is difficult for any single investor or group of investors in a publicly listed entity to manipulate the entity to obtain treaty benefit. This is equally the case for investors in widely-held non-CIV funds. Treaty shopping should not be a concern in these cases.

Question 4: Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for a proposed exception and if yes, would intermediate entities be required to
distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

We consider that the concerns about deferral of tax are misplaced and entirely overlook the purpose of investment funds. Investment funds seek to give the same return to a group of investors investing together in assets as if they had invested directly in the assets. If tax applied both at the fund level and at investor level, investing through non-CIV funds would be disadvantageous compared to investing directly. Such a system would reduce the type of investments available to smaller investors (compared to a system that imposes tax at a single level).

In addition, the concerns about deferral of tax seem to apply only in restricted circumstances. For example, if a domestically distributed non-CIV fund can confirm that its investors are domestically resident, it should satisfy paragraph 2(e) of the LOB, regardless of whether the non-CIV fund pays tax or not or distributes income earned or not. In that case, the deferral of tax does not appear to be a concern, or at least it does not impact the fund's ability to claim treaty benefit. Similarly, concerns about deferral of taxed do not arise where income in respect of which treaty relief is claimed is paid to privately held or publicly listed entities who may not pay tax on the income due to the availability of tax losses, tax depreciation or domestic exemptions from tax. We believe that it is appropriate in those cases to permit treaty relief and that approach should also be followed for non-CIV funds.

It is important to bear in mind that even though some investors may not be taxed currently on the income received by the non-CIV fund they will be taxed either on distribution or when the units are sold.

Finally, the suggestion that mandatory distribution provisions should be required before a fund can be eligible for treaty relief should not be followed. Such a requirement would negatively impact the range of long-term investment options available to investors. Countries contemplating introducing such provisions should consider how the requirement would interact with an anti-conduit rule.

Question 5: States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

We do not agree that treating a widely-held regulated fund as a qualified person under the LOB is more generous treatment than that available to listed entities. Each set of criteria is designed to apply to a different category of qualified person.

For example, it is not suggested that listed companies are treated more or less favourably under paragraph 2(c) of the LOB than entities that meet the required ownership criteria under paragraph 2(e). These are simply two different types of tests that are applied to two different types of taxpayer. It is impossible to apply the test in 2(e) to listed entities and accordingly a different test is required. This is equally the case for CIV and non-CIV funds.

The existing criteria are inappropriate for CIV and non-CIV funds and cannot be applied. Accordingly appropriate criteria that can be measured in practice must be developed. It would be very difficult for any investor or group of investors to manipulate a widely-held regulated
fund. That therefore seems like a reasonable category to include as a qualified person in the LOB.

3 Non-CIV funds set up as transparent entities

Question 7: Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

We agree that where countries’ domestic laws provide for entities with a wide investor base to be treated as transparent for domestic tax purposes, those countries should seek to agree that those entities are also treated as transparent for the purposes of their double tax treaty. For investors in those entities that are resident elsewhere, this approach only solves part of the problem.

Investors resident in a third country can suffer withholding tax on source country payments even in circumstances where the investor jurisdiction has a double tax treaty with the source country that provides a full exemption from withholding tax. In practical terms, the source state may disregard the transparency of the investment entity and refuse to refund withholding tax suffered by the investor on payments received. Even if a provision of the type described in paragraph 9 of the Discussion Draft is included in the double tax treaty agreed between the source state and the country of residence of the investment entity, it will not bind the source country to grant treaty relief to an investor resident in a third country. In practical terms, the question of granting treaty relief to investors in a transparent entity is usually a tripartite matter requiring input from all three jurisdictions. There is currently no process for countries coordinating on any basis other than a bilateral basis to resolve multi-jurisdictional issues.

One point to note in relation to the commentary in paragraph 14 of the Discussion Draft, in our experience securitisation companies are usually treated as opaque in the jurisdiction of their establishment (this is certainly the case for Irish securitisation vehicles). The commentary in paragraph 14 implies that securitisation vehicle may be treated as transparent in its country of establishment. In our experience, that is not the case for securitisation companies in many countries.

4 Derivative benefit rule applicable to non-CIV funds

4.1 Questions related to the identification of the investors in a non-CIV

Question 13: Is the ownership of interest in non-CIV funds fairly stable or does it change frequently like the interest in a typical collective investment fund that is widely distributed?

It depends, some non-CIV funds have quite stable ownership, whereas for others ownership can change frequently.

Question 14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?
We do not believe that any proposal that requires confirmation of the place of residence and tax profile of investors is workable for non-CIV funds who cannot determine who their ultimate beneficial owners are.

As raised in our previous submissions, certain non-CIV funds, notably debt issuance companies that issue listed debt into a clearing system, are unable to confirm who holds that debt. All the economic return is paid out on debt securities. This fact profile, which is a very common profile, has not yet been addressed through the work under Action 6.

Non-CIV funds that are unable to confirm ultimate beneficial ownership should not, for that reason, be denied treaty relief in the absence of any evidence that the entity was established or is being used for treaty shopping. An alternative test must be developed for these types of entities.

If fully implemented, the Treaty Relief and Compliance Enhancement project ("TRACE") may go some significant way to assisting securitisation companies that issue notes into clearing systems identify who holds their debt but only if the clearing systems and other intermediaries agree to become authorised for the purposes of TRACE. It is unclear if TRACE will be fully implemented. To the extent the OECD adheres to a test of ownership and a test of ownership only to determine who should be entitled to claim treaty benefit, the full implementation of TRACE is critical.

Question 15: What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example, under anti-money laundering, FATCA or common reporting standard rules)?

The type of information held will depend on the type of non-CIV fund and the nature of their investors. Some non-CIV funds will obtain full KYC information and will clearly be able to identify all of their investors. For those funds, confirming whether or not an ownership-based test is satisfied in a LOB should not be problematic.

However, some non-CIV funds, including companies that issue debt to a clearing system do not hold KYC information in relation to their investors. Furthermore, from a FATCA / CRS perspective, those non-CIV funds are generally required only to confirm that interest payments are made to a clearing system and are not in a position to obtain or provide information beyond the level of the clearing system. The clearing system generally has its own FATCA / CRS reporting obligations.

Question 16: Is this information currently sufficient for the relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlements of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

The information held by non-CIV funds is, in most cases, not currently sufficient to identify the treaty benefits that an owner would have been entitled to if it had received the income directly. As many non-CIV funds have no contact with the ultimate investors and do not know who the
ultimate investors are, it is currently impossible for many non-CIV funds to obtain the documents required to confirm whether or not those investors would be entitled to claim treaty benefit.

The full implementation of TRACE may provide a solution to the issues that arise for some non-CIV funds where treaty benefit is available only by reference to an ownership test. A solution based on TRACE would require full participation of all financial intermediaries including clearing systems.

4.2 Questions related to the prevention of treaty shopping

Question 17: Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits.

Non-CIV funds that cannot confirm who their owners are should not automatically be denied treaty benefits. Instead, an alternative and workable test must be devised to determine when non-CIV funds are entitled to claim treaty benefit.

If the OECD adheres to a treaty entitlement test based on ownership, it is incumbent upon the OECD to ensure that TRACE is fully implemented so that the test adopted is workable for taxpayers investing through non-CIVs.

Question 18: The proposal would grant treaty benefits if a certain high percentage of a non-CIV fund is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty shopping as a 20% participation in a very large fund could represent significant investment. How could this concern be addressed?

This concern seems inconsistent with the inclusion of paragraph 2(e) in the agreed LOB which permits treaty benefit to be granted to companies that are at least 50% owned by individuals resident in the same jurisdiction as the company. Is there a concern that paragraph 2(e) could leave room for treaty shopping? Or is a higher threshold proposed for non-CIV funds? If so, why?

Question 19: One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

The concern implied in question 19 seems inconsistent with the derivative benefits provision included in paragraph 3 of the LOB which applies a 50% base erosion test. Both questions 18 and 19 tend to indicate that a higher threshold should be applied to non-CIV funds seeking to claim treaty relief. This would not appear to be reasonable.

4.3 Questions related to the new derivative benefit provision of the United States Model

Question 22: The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefit provision that appeared in the detailed version of the LOB rule included in the
Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty related on 12 February 2016. Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the ‘seven of fewer’ condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

As noted throughout this submission, certain non-CIV funds cannot confirm who their investors are and therefore any test based on ownership (such as the derivative benefits provision) is not workable for those entities. However, unless there is a treaty shopping intention or purpose, we believe that treaty entitlements should nevertheless not be denied for such non-CIV funds.

In addition, the restriction of the derivative benefits provision in the United States Model to companies seems unnecessary. If a similar provision is to be adopted for non-CIV funds, it should apply to “any person other than an individual”.

5  Suggestion that a “substantial connection” approach should be adopted

Question 23: Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

We support the proposal to devise a treaty benefit test for non-CIV funds based on criteria other than ownership (be that the “substantial connection” approach or otherwise). This approach recognises that although not all non-CIV funds can confirm who their investors are, those entities are not established for treaty shopping and accordingly, should be permitted to claim treaty relief.

If a meaningful proposal based on criteria other than ownership is to be adopted, it simply will not be possible in all cases to confirm that the ultimate investors in the fund would obtain similar benefits under a treaty agreed between their country of residence and the source country. Nor will it be possible to confirm that those investors are taxed on a current basis on the income of the fund. However, that should not result in a proposal for a test based on criteria other than ownership being abandoned.

6  Suggestion of a “Global Streamed Fund” (“GSF”) Regime

Question 24: Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons determine who their investors are?
- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

The GSF proposal merits consideration. It recognises that those investing in non-CIV funds should be no worse off than if they invested directly in the asset. We agree with this position.

The proposal, in our view, is not dissimilar to TRACE but the point of collection of tax changes from the source country to the country of residence of the fund. If the GSF proposal is to be considered as an option, it should be carefully compared with TRACE to confirm that it offers clear advantages over TRACE. In the absence of clear advantages, adopting the GSF proposal instead of (or in parallel with) TRACE may be unwise. Time and resources have been invested in developing TRACE and the project should only be discarded if GSF offers an improved mechanism for determining how non-CIV funds should be entitled to claim treaty relief.

The TRACE Implementation Package was agreed in January 2013 and has not progressed quickly. This suggests a lack of political will to resolve the question of treaty access for non-CIV funds. Unless that changes, there is limited benefit in redesigning a new mechanism based on the GSF proposal to resolve the same question.

Additional Examples for the Commentary on the PPT

Question 25: Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

See Schedule 1.

Concerns with respect to anti-conduit arrangements

Question 26: Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

CIV and non-CIV funds are established to facilitate the commercially beneficial activity of collective investment and this should be encouraged by the OECD. In the vast majority of cases, the PPT should not apply to CIV and non-CIV funds and treaty relief should be available. We agree that if a CIV or non-CIV fund entered into an arrangement, the principal purpose of which was to obtain treaty benefit, that fund should be denied treaty benefit under the terms of the PPT.

Given CIV and non-CIV funds are established to facilitate bona fide collective investment, typically returns earned by such funds will be paid out to investors. The distribution of returns to investors in CIV and non-CIV funds should not of itself trigger an anti-conduit provision. Anti-conduit rules should only apply where the principal purpose of the CIV or non-CIV fund is
to obtain treaty benefit. It should be clarified in the commentary on the use of anti-conduit provisions that the flow-through nature of CIV and non-CIV funds of itself should not be sufficient to trigger anti-conduit rules.

9 Concerns related to the “special tax regimes” proposal

Question 27: Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indication where they have similar or different concerns with respect to the new version of the proposals that was included in the new United States Model Tax Treaty released in February 2016 (see question 22) above. If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

Although no detailed commentary is available on the new version of the "special tax regime proposal", it may be possible that a CIV or non-CIV fund would be capable of falling within the regime. Many CIV and non-CIV funds are exempt from tax on their income. It is possible that this would bring such entities within paragraph (i) of the special tax regimes provision. Once a CIV or non-CIV fund has satisfied a LOB provision, it should be entitled to treaty benefit.

In our view, it would be clearly wrong to deny treaty benefit to a CIV or non-CIV fund that had satisfied the LOB on the basis that it benefits from a “special tax regime”. CIV and non-CIV funds are designed to give investors the same return as though they invested in the underlying assets directly. The carve-outs included in paragraph (iv) should be extended to reflect a broader category of CIV and non-CIV funds.

Should you wish to discuss any of the comments raised, please let us know.

Yours faithfully

MATHESON
Schedule 1

1 **Securitisation company**

RCo, a securitisation company resident in State R, was established by a bank which sold to RCo a portfolio of loans and other receivables owed by debtors located in a number of jurisdictions. RCo is fully debt-funded. RCo has issued a single one dollar share which is held on trust and has no economic value. RCo’s debt finance was raised through a note issuance. The notes are widely held by investors and are held in a clearing system and are listed on a recognised stock exchange. To comply with regulatory requirements, the bank also retained debt securities issued by RCo. RCo currently holds 60% of its portfolio in receivables of SMEs resident in State S, in respect of which it receives regular interest payments. Under the tax convention between State R and State S, the withholding tax rate on interest is reduced from 30% to 10%.

In establishing RCo, the bank took into account a large number of issues, including a robust securitisation framework, securitisation legislation, skilled and experienced personnel and support services in State R and the existence of tax benefits provided under State R’s extensive tax convention network. It is likely that a majority of investors in RCo would be financial institutions and pension funds located in OECD member states. Investors’ decisions to invest in RCo are not driven by any particular investment made by RCo and RCo’s investment strategy is not driven by the tax position of the investors. RCo is taxed in State R on income earned and is entitled to a full deduction for interest payments made to investors.

In making its decision to sell receivables owed by companies resident in State S, the bank and RCo considered the existence of a benefit under the State R / State S tax convention with respect to interest, but this alone would not be sufficient to trigger the application of paragraph 7. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, unless RCo’s investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R / State S tax convention to RCo.

2 **CIV**

RCo, a collective investment vehicle resident in State R, manages a diversified portfolio of assets. The interests in RCo are widely-held. RCo currently holds 60% of its portfolio in shares of companies resident in State S, in respect of which it receives annual dividends. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30% to 10%.

RCo’s investment decisions take into account the existence of tax benefits provided under State R’s extensive tax convention network. A majority of investors in RCo are residents of OECD member states or countries with which State S has a tax convention. Investors’ decisions to invest in RCo are not driven by any particular investment made by RCo and RCo’s investment strategy is not driven by the tax position of the investors. RCo is subject to investor protection regulation in State R and is not taxed in State R on income or gains.
In making its decision to invest in shares of companies resident in State S, RCo considered the existence of a benefit under the State R / State S tax convention with respect to dividends, but this alone would not be sufficient to trigger the application of paragraph 7. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, unless RCo’s investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R / State S tax convention to RCo.
April 22, 2016

Via email: taxtreaties@OECD.org

Tax Treaties
Transfer Pricing and Financial Transactions Division
OECD/CTPA
2, rue André Pascal
75775 Paris Cedex 16
France

Re: Managed Funds Association Comments on Discussion Draft, Treaty Entitlement of Non-CIV Funds

Dear Sir / Madam:

The Managed Funds Association¹ appreciates the opportunity to submit for your consideration comments regarding the Organisation for Economic Co-Operation and Development’s (“OECD”) consultation document on the Treaty Entitlement of Non-CIV Funds, as part of its Base Erosion and Profit Shifting (“BEPS”) project. We support the goals underlying the OECD’s project of preventing tax abuse in connection with granting tax treaty benefits.

We also believe that it is important for the BEPS project to establish a treaty benefit framework that avoids imposing double taxation on investors who would be entitled to treaty benefits when making a direct investment, but that choose to invest through a pooled investment vehicle, such as a private investment fund, in order to have some of their capital managed by third-party managers. As we noted in our June 2015 letter responding to the prior consultation paper on BEPS Action 6,² to the extent investors, including pension plans, sovereign funds, endowments, and charitable foundations, would be subjected to an additional layer of tax simply because they choose to invest through a pooled vehicle, they likely would no longer choose to invest through that type of asset management structure. Those investors that forego such investments would thereby forego the potential returns they generate from investing in

¹ The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

private funds, and the available private fund capital for international investment would shrink to that extent.

We continue to believe that any regulated, "widely-held" CIV, such as a U.S. mutual fund or a European UCITS fund, should qualify as a treaty resident and as a per se “qualified person,” in addition to our proposed framework for non-widely held investment funds.

We further encourage the OECD to develop a framework for non-widely held investment funds that would allow them to be regarded as collective investment vehicles (“CIVs”) and therefore qualify for treaty benefits on the basis set out below. We believe that the appropriate requirement for an investment fund to be regarded as a CIV should be that the fund or the fund’s investment manager is subject to regulation in the country in which it was established3 – for example, alternative investment funds with investment managers subject to regulation under the Alternative Investment Fund Managers Directive (the “AIFMD”). We believe that limiting the definition of CIV to these regulated funds significantly reduces the risk of providing tax treaty benefits to entities structured to avoid taxes. Regulated funds and their managers are subject to significant compliance and regulatory costs and provide significant transparency to their government regulators with respect to their investment activities and, as such, are highly unlikely to be established or operated as tax avoidance vehicles.

Including regulated funds within the scope of the definition of a CIV also would allow the OECD to use relevant definitions from the securities and financial services regulations of a treaty country, rather than having to create a stand-alone definition for purposes of tax treaties, which could cause confusion and uncertainty for market participants and policy-makers.

To the extent the OECD does not agree with the above recommendation, at a minimum, we believe the OECD should include funds that are regulated in their country of establishment within the definition of a CIV. As a precedent, the tax treaty between Ireland and the United States does not include references to “widely-held” or “diversified”; it simply refers to “Collective Investment Undertakings”, which includes Irish Qualifying Investor Alternative Investment Funds (“QIAIFs”) that are not widely-held.

We acknowledge the OECD’s concerns that regulation alone may not fully address concerns about treaty shopping by investors. To address these concerns, we believe the framework for CIVs that are not widely-held but regulated should permit such investment funds to receive proportional treaty benefits, to the extent that ultimate investors in a fund would be entitled to treaty benefits if they had made the investment directly, rather than through a pooled investment fund. We believe this two-step framework would address OECD’s concerns about treaty-shopping.

We note that the commentary regarding CIVs in the OECD’s October 2015 report focused on widely-held CIVs. We believe the OECD should provide explicit commentary regarding non-widely held CIVs, which would, at a minimum, provide greater clarity to OECD members that choose to address non-widely held investment funds through bilateral treaties. We would suggest the OECD provide the following guidance:

3 In this letter, we refer to investment funds subject to regulation or whose investment manager or investment adviser is subject to regulation with respect to the management of the investment fund as “regulated funds.”
As with CIVs, private investment funds are a type of collective investment vehicle that provide investors the ability to pool capital with other investors for the purpose of having an asset manager make investment decisions, except that private investment funds raise capital through private placements instead of public offerings. While some private investment funds may be widely-held and regulated in the country of establishment, other funds may not be widely-held or directly regulated at the fund level. Private investment funds generally are subject to investor-protection regulation through regulation of the manager, with respect to the management of such funds, in the country in which the manager operates. Denying treaty benefits to non-widely held private investment funds presents the same risk of double taxation on their investors as on investors in widely-held funds. States may wish to expand the scope of the term “collective investment vehicle" (“CIV”) to include those funds that are not widely-held and that are subject to investor-protection regulation of the fund directly or through regulation of the fund’s manager with respect to management of the fund, in either the fund’s country of establishment or the country in which its manager is regulated. Weighing against such risk of double taxation is the concern that providing treaty benefits to non-widely held regulated funds would present risks of treaty shopping or other tax abuse. In considering options for providing treaty benefits to non-widely held regulated funds, States should consider granting treaty benefits in proportion to the treaty benefits that their ultimate investors would have been entitled to receive had they made the investment directly, as this option is consistent with the neutrality principle and addresses treaty-shopping concerns. In considering when to grant proportional treaty benefits to non-widely held, regulated, investment funds, States should consider fixed, periodic documentation requirements for establishing the tax residence of their investors, which, in some cases, may require funds to obtain documentation or certifications from intermediary investors.

Set out below are the questions from the OECD's Consultation Paper and MFA’s responses. We note that we have not responded to all of the questions set out in the Consultation Paper.

SUGGESTION THAT TREATY BENEFITS BE GRANTED TO REGULATED AND/OR WIDELY-HELD NON-CIV FUNDS

1. What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

We have considered various definitions used to define "widely held" in the context of funds such as the U.K. investment manager exemption and the Australian Investment Manager Regime. Based on the foregoing, we would suggest the following test, which we consider clear enough to be workable and broad enough to allay concerns that a fund is being used to secure treaty benefits.

A CIV would be regarded as ‘widely held’ if the fund has at least 50 beneficial owners of the fund’s capital interests, and no single beneficial owner owns more than 20% of the capital interests in the fund (counting an owner and its connected persons as a single beneficial owner for purposes of the foregoing).

As noted above, we continue to believe that any regulated, "widely-held" CIV, such as a U.S. mutual fund or a European UCITS fund, should qualify as a treaty resident and as a per se “qualified person,” in addition to our proposed framework for non-widely held investment funds.
2. What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

We believe there are a variety of regulatory frameworks that provide investor protections that should be deemed acceptable for purposes of our proposal set out above. Regulatory frameworks that provide for (1) fund or fund manager registration or similar notification requirements with a government agency; (2) government oversight of the fund or manager through reporting and/or examination authority; and (3) rules regarding operational or compliance obligations should be deemed acceptable for purposes of our proposal. We believe the AIFMD in EU Member States that have implemented it, the Irish QIAIF, the Luxembourg Specialised Investment Fund, the U.S. Investment Advisers Act of 1940, and the Resident Fund Scheme in Singapore are all examples of regulatory frameworks that should be deemed acceptable, as should other similar regulatory frameworks. In that regard, we would note that the new draft EU Directive on tax avoidance contains a concept of "financial undertaking" which benefit from certain safe harbors and which includes an “alternative investment fund” managed by an “alternative investment fund manager”, each as defined in the AIFMD. We encourage the OECD to similarly consider referencing regulatory frameworks such as the AIFMD for purposes of determining the scope of investment funds eligible to obtain treaty benefits.

The AIFMD imposes substantive requirements on fund managers subject to regulations under the Directive, including: authorization as an alternative investment fund manager; regulatory reporting to government authorities; disclosures to investors; requirements to use third-party depositaries; and requirements to have policies and procedures regarding issues such as valuation of investment fund assets, conflicts of interest, and risk and liquidity risk management related to the investment fund. Notably, the AIFMD applies to managers of “alternative investment funds”, which the Directive defines as “collective undertakings, including investment components thereof, which: (i) raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (ii) do not require authorisation (under the UCITS Directive).” As such, we believe these regulatory requirements provide a useful framework for determining that an investment fund is subject to regulation and engaged in meaningful activities as an investment fund, similar to UCITS funds or U.S. mutual funds.

Similarly, investment advisers registered under the U.S. Investment Advisers Act of 1940 are subject to reporting to government authorities; disclosures to investors; requirements to keep client securities and funds with qualified custodians, undergo annual audits of the funds they manage; have a chief compliance officer and compliance policies and procedures designed to ensure compliance

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4 Directive 2011/61/EU.

5 To distinguish from publicly-offered, regulated funds such as U.S. mutual funds and UCITS, we refer generally herein to the investment funds that constitute the bulk of the funds managed by our member firms as private investment funds.
with U.S. securities laws. Notably, for a person or entity to be an investment adviser, that person has to engage in the business of advising other people, for compensation, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. Similar to the AIFMD, we believe these regulatory requirements provide a useful framework for determining that an investment fund is subject to regulation and engaged in meaningful activities as an investment fund, similar to UCITS funds or U.S. mutual funds.

Under our proposal, non-widely held investment funds subject to a regulatory framework of the type described, above, would only be entitled to proportional treaty benefits, which would require investment funds to be able to identify the tax residences of their ultimate investors. As such our proposal is designed to ensure that investment entities formed and operated for the purpose of pooling investor capital for investing purposes would be entitled to receive at most the same treaty benefits that the investors in the fund would have received had they invested directly. Our proportional treaty benefits proposal prevents treaty shopping by investors and is consistent with the neutrality principle recognized by the OECD. For further detail regarding how funds can determine the tax status of their investors, see our answer to question 14 below.

3. Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

   See our proposed framework above regarding proportional treaty benefits based on the ability of ultimate investors to obtain treaty benefits had they invested directly.

4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

   It is not correct that investors in private investment funds are typically taxable only when they receive a distribution. For example, taxable U.S. taxable investors invest through fund entities that are transparent for U.S. tax purposes – so they are taxable on their allocation of income regardless of whether they have received a distribution. Further, many institutional investors in private investment funds are exempt from taxation in their state of residence – either as pension funds and/or as government institutions enjoying sovereign tax immunity – and, as such, would not be taxed upon distribution. As shown on the following chart, which is derived from Preqin’s 2016 Global Hedge Fund Report, the vast majority of capital invested in hedge funds, which are a

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6 Preqin’s 2016 Global Hedge Fund Report is available (fee required) at: https://www.preqin.com/item/2016-preqin-global-hedge-fund-report/2/13359. The term “hedge fund” is sometimes used interchangeably with “alternative investment fund”, but we note a distinction among private investment funds between hedge funds and private equity funds in our answer to Question 13, below.
particular type of private investment fund, comes from tax-exempt investors such as public and private sector pension plans.

Breakdown of Institutional Investor Capital Invested in Hedge Funds by Investor Type

<table>
<thead>
<tr>
<th>Investor Type</th>
<th>Dec-14</th>
<th>Dec-15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Pension Fund</td>
<td>20%</td>
<td>23%</td>
</tr>
<tr>
<td>Private Sector Pension Fund</td>
<td>19%</td>
<td>19%</td>
</tr>
<tr>
<td>Sovereign Wealth Fund</td>
<td>11%</td>
<td>11%</td>
</tr>
<tr>
<td>Endowment Plan</td>
<td>11%</td>
<td>11%</td>
</tr>
<tr>
<td>Asset Manager</td>
<td>10%</td>
<td>8%</td>
</tr>
<tr>
<td>Foundation</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>Insurance Company</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>Bank</td>
<td>6%</td>
<td>3%</td>
</tr>
<tr>
<td>Family Office</td>
<td>3%</td>
<td>2%</td>
</tr>
<tr>
<td>Wealth Manager</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Corporate Investor</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Superannuation Scheme</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Other</td>
<td>1%</td>
<td>1%</td>
</tr>
</tbody>
</table>

We do not believe that the proposed exception for proportional treaty benefits for regulated funds should contain a mandatory distribution requirement. Requiring investment funds that invest in more illiquid assets to have mandatory redemptions would raise investor protection and other concerns identified by securities regulators by creating potential mismatches in the liquidity of the portfolio of assets and the liquidity of investor redemption rights. In particular, any mandatory distribution requirement to qualify for treaty benefits would shrink the pool of long-term capital provided by private investment funds that is needed for the type of less liquid investment strategies that provide recovery capital during economic downturns.

We believe concerns about deferral of income are best addressed by the residence countries of investors, through anti-deferral rules such as the U.S. passive foreign investment company (“PFIC”) framework or the U.K. reporting fund framework. We would note that if there is any deferral for investors under the tax laws of their residence State, that deferral presumably applies to both income and loss – so the issue is not solely deferral of income.

Under U.S. tax rules, an investment fund that holds assets through a foreign corporation generally would be deemed a PFIC, which is defined as a foreign corporation with either 75% of its gross income as passive income or if the average percentage of assets which produce passive income (or are held for the purpose of producing passive income) is at least 50%. Direct and indirect U.S.
shareholders of a PFIC are all subject to PFIC rules and are subject to U.S. tax as set out in the rules. We believe the U.S. PFIC rules provide an example of an anti-deferral framework that individual jurisdictions could consider as a means of addressing policy concerns regarding investor deferral of income.

We believe the U.K. reporting fund regime also provides such an example.\(^7\) The reporting fund framework replaced the U.K.’s prior distributing fund framework for offshore funds, which created significant challenges for many investment funds. Reporting funds must comply with reporting requirements to investors and to U.K. tax authorities that include the income returns for the offshore fund on a per-share basis for each reporting period. U.K. investors in reporting funds are then subject to tax on cash distributions from the fund as well as any excess reportable income (i.e., they are subject to tax on the offshore fund’s reportable income even if that income is not distributed). Under the reporting fund regime, U.K. investors in offshore funds that are non-reporting funds are subject to higher taxes on the sale or other disposal of their interest in the fund, creating a strong disincentive to invest in non-reporting funds.

5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

As discussed above, our proposed framework would only provide proportional treaty benefits to non-widely held, regulated investment funds.

6. One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

We believe the investor identification issues discussed elsewhere in this letter are of greater relevance with respect to intermediaries than concerns about cascading tax. See our response to question 17 for discussion on treaty eligible investors that invest through intermediary entities.

**NON-CIV FUNDS SET UP AS TRANSPARENT ENTITIES**

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent

\(^7\) We note that Germany, Italy, Switzerland, Austria, and Denmark also have their own anti-deferral regimes with similar foreign fund reporting rules.
entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

A fund vehicle that is fiscally transparent in its residence State and the source State is impracticable for funds with a wide investor base. Such transparent vehicles are economically viable only in very limited circumstances – primarily in a fund with a single investor that is willing to comply with its own tax filing obligations and claim its own treaty benefits in respect of the fund’s investments. The vast majority of the investors that invest in private investment funds do not have the resources to undertake such efforts for each of a fund’s investments that would be directly attributed to them in a fiscally transparent structure. It is part of the economic efficiencies of pooling capital in a fund vehicle that such a vehicle can claim treaty benefits and comply with tax filing obligations on its own behalf and spare each of its investors of the duplicative time and effort of doing so.

SUGGESTION THAT THE LOB INCLUDE A DERIVATIVE BENEFIT RULE APPLICABLE TO CERTAIN NON-CIV FUNDS

8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

Institutional investors, broadly speaking, are all investors other than individuals. As noted in the table provided in our answer to Question 4, the institutional investors that comprise the largest percentage of capital invested in hedge funds – public and private pension funds, sovereign funds, endowments, and foundations are generally tax-exempt in their residence State. Further, many taxable institutional investors (such as insurance companies, banks, and corporates) are eligible for treaty benefits in their own right, because corporate capital comes primarily from companies resident in treaty countries. For this reason, treaty shopping is not pursued by the institutional investors that comprise the vast majority of capital invested in hedge funds – rather, their concern is about whether they lose treaty benefits by investing in a hedge fund or other private investment fund. For private investment fund investors, the use of a treaty eligible fund vehicle aims to preserve neutrality.

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

See our response to question 2 above.
10. Paragraph 17 above refers to the possible inclusion of “specific anti-abuse rules”. What would these rules be?

We have no comment on this question.

11. What would constitute a “bona fide investment objective” for the purpose of paragraph 17 above?

We have no comment on this question.

12. How would it be determined that a fund is “marketed to a diverse investor base” for the purpose of paragraph 17 above?

We have no comment on this question.

QUESTIONS RELATED TO THE IDENTIFICATION OF THE INVESTORS IN A NON-CIV

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

The answer is both of the above. The stability of the ownership of private investment funds depend on whether they are open and evergreen (sometimes referred to as “hedge fund” style within the private investment fund industry) or closed with a limited term (sometimes referred to as “private equity” style). A private investment fund may be open and evergreen in the sense that new investors can be admitted (through private placement), existing investors can redeem their interests (only at specified intervals and with advance notice), and the fund does not expect to liquidate and return all capital to investors in the foreseeable future. A private investment fund is closed with a limited term if investors do not have the right to redeem their investment and have to await the return of their capital at end of the fund’s fixed term. Whether a private investment fund is structured as an open or closed fund is largely determined by the type of assets it plans to hold or trade. Funds pursuing liquid trading strategies tend to be open; funds pursuing less liquid, long-term investments tend to be closed. It is a matter of trying to match the liquidity and term of the capital with the liquidity and term of the assets for which the capital is intended.

14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

Investors in many private investment funds hold their interests directly, rather than in “street name” as with listed securities. Further, regulatory requirements, including know your customer rules, U.S. Foreign Account Tax Compliance Act (“FATCA”), U.K. Agreements with Crown Dependencies and Overseas Territories (“U.K. CDOT”), and OECD’s Common Reporting Standards (“CRS”) require fund managers to gather information about their investors. To the extent investment funds have intermediary investors, such as funds of funds or bank-sponsored funds,
those intermediary investors can conduct similar diligence on their investors to provide representations or certifications to the investment fund seeking proportional treaty benefits. We note that other tax frameworks, including FATCA, U.K. CDOT, and CRS recognize that investor certifications are an important mechanism for investment funds and other entities to be able to use as part of their diligence process. Under our proposed proportional approach, investment funds would only be entitled to proportional treaty benefits to the extent they can determine the tax status of their investor base.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

Managers collect information about investors under a variety of regulations, to the extent applicable, including anti-money laundering rules, U.S. FATCA, U.K. CDOT, and CRS.

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

This information currently collected from investors generally is not sufficient for purposes of our proposed proportional benefits framework. We therefore strongly support the adoption of the investor self-certification system developed in TRACE as a mechanism to document the investor's tax status and remit the appropriate information to tax authorities, and urge the OECD to encourage member States to do so. We note that even if TRACE’s “authorized intermediary system” is not adopted by member States, member States could adopt or adapt TRACE’s investor self-certification form or a TRACE-type of self-certification, for example by extending established FATCA or CRS self-certification processes.

QUESTIONS RELATED TO THE PREVENTION OF TREATY-SHOPPING

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

As discussed above, our proposal would only provide proportional treaty benefits to an investment fund to the extent the fund is able to document the information necessary to determine the treaty eligibility of ultimate investors. Many intermediary entities are under common control of the managers of the investment fund and would not present additional challenges. For intermediary
entities not under common control, those intermediaries could provide representations or certifications regarding their ultimate owners and proportional benefits would be given to the extent the ultimate investors would be entitled to treaty benefits if they invested directly.

Enclosed with this letter is a structure diagram as an illustrative example of a potential future fund structure that might be used by private investment funds if our proposed framework for non-widely held CIV were adopted by contracting States.

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

While we do not oppose such an approach, our proposed framework would only provide proportional treaty benefits to non-widely held, regulated investment funds. We note as a precedent that the LOB provision in the U.S. Model Treaty would grant treaty benefits for a resident company if at least 95% of its shares are directly or indirectly owned by equivalent beneficiaries. (We also note in our answer to Question 22, below, that the U.S. Model Treaty LOB provision is problematic in several respects for non-widely held, regulated funds.)

19. One of the proposed requirements for the application of the suggested derivative benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

The regulated private investment funds that we propose should be eligible for proportional treaty benefits are generally not taxed at the entity level by the residence State (provided that the entity complies with applicable regulations). As such, a base erosion test should not apply to such funds.

QUESTIONS RELATED TO THE PREVENTION OF DEFERRAL

20. According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

We understand tax authorities’ policy concerns with respect to deferral of income. As discussed above in response to question 4, however, given the significant percentage of capital invested by tax-exempt entities, we believe that the potential for deferral is substantially lower than generally perceived, and that such concerns about deferral of income are best addressed by the
residence countries of investors, through rules such as the U.S. PFIC framework or the U.K. reporting fund framework, rather than as part of the Action 6 workstream, which we believe is more appropriately focused on issues relating to treaty shopping.

21. As regards the application of the proposal in the case of indirect ownership, who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis?

We have no comment on this question.

QUESTIONS RELATED TO THE NEW DERIVATIVE BENEFITS PROVISION OF THE UNITED STATES MODEL

22. The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivative benefits provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016. Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the “seven or fewer” condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

We believe that a derivatives benefit provision in general is likely to problematic for many private investment funds, which is why we encourage adopting our proposed approach of proportional treaty benefits for regulated, non-widely held investment funds. Other problems with the U.S. Model Treaty’s LOB provision include its base erosion restriction, its restrictive definition of “equivalent beneficiary,” and the minimum six-month period (over a trailing twelve-month period) for which the ownership by equivalent beneficiaries must be demonstrated. In some regulated funds, the tax exemption may operate by granting a tax deduction for dividends paid by the fund (as is the case with U.S. mutual funds). But that type of tax exemption is intended to act as penalty for a fund that does not comply with the applicable regulations and should not inadvertently be subject to base erosion restrictions under an LOB provision. And the U.S. Model Treaty’s definition of “equivalent beneficiary” in effect exports the U.S. style LOB requirements to the equivalent beneficiary’s resident State tax treaty with the source State that is being tested for equivalent benefits. In sum, our proposal for proportional treaty benefits to the extent of a fund’s investors that are equivalent beneficiaries is an altogether different LOB regime than the one contained in the U.S. Model Treaty.

SUGGESTION THAT A “SUBSTANTIAL CONNECTION” APPROACH BE ADOPTED

23. Are there practicable ways to design a “substantial connection” approach that would not raise the treaty-shopping and tax deferral concerns described in paragraph 21 above?

We have no comment on this question.
SUGGESTION OF A “GLOBAL STREAMED FUND” REGIME

24. Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?
- Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?
- Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?
- What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

We believe that the GSF framework accords with the principle of proportional benefits that we advocate and may therefore be appropriate for certain types of investment funds; however, not all private investment funds are able to make current distributions without creating investor protection or other regulatory concerns (see our answer to Question 13, above). To the extent the OECD considers the GSF framework, we believe it should do so only as one potential option for investment funds and not as the sole option. Moreover, we are concerned that the GSF framework may take longer to resolve than the other elements of the consultation and therefore potentially delay their resolution.

ADDITIONAL EXAMPLES FOR THE COMMENTARY ON THE PPT RULE

25. Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

We believe that a widely-held, regulated investment fund (as described in our response to question 2 above) should automatically pass the PPT. We also believe that a non-widely held, regulated investment fund (as described in our response to question 2 above) and which seeks to claim proportional treaty benefits should be deemed to pass the PPT. In fact, the OECD’s wording of the PPT includes an exception for granting treaty benefits that “would be in accordance with the object and purpose of the relevant provision of this Convention” (emphasis added). Granting proportional treaty benefits to eligible funds pursuant to a specific treaty provision would be “in accordance with the object and purpose of the relevant provision.”
For any other type of investment fund or investment entity, guidance should be provided to assist in determining whether that fund or entity has been formed with a principal purpose of obtaining treaty benefits. This should include a list of factors that would indicate no such purpose such as where there is diversity of investors, diversity of investments, a significant proportion of investors entitled to treaty benefits if they held the investment directly, prospectus documentation indicating clear commercial objectives, investor preference for legal regime, political stability, investor familiarity and preferred professional service providers in the chosen jurisdiction. The mere fact that the jurisdiction in which the entity is formed has a wide network of double tax treaties should not, of itself, indicate that obtaining treaty benefits is a principal purpose of the entity or investments its makes.

CONCERNS WITH RESPECT TO CONDUIT ARRANGEMENTS

26. Commentators who share the concern described above in relation to conduit arrangements are invited to provide one or more examples where the PPT rule could apply to legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19 of the Commentary on the PPT rule included in paragraph 26 of the Report. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

We have no comment on this question.

CONCERNS RELATED TO THE “SPECIAL TAX REGIMES” PROPOSAL

27. Commentators who shared the concern described above in relation to the proposal for “special tax regime” rules are invited to indicate whether they have similar or different concerns with respect to the new version of the proposal that was included in the new United States Model Tax Treaty released in February 2016 (see question 22 above). If yes, what is the type of “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to these concerns?

We have no comment on this question.

OTHER SUGGESTIONS

28. Please describe briefly any approach not already mentioned in this consultation document or in previous comments that could address concerns related to the way in which the new treaty provisions included in the Report on Action 6 may affect the treaty entitlement of non-CIV funds without creating opportunities for treaty-shopping or tax deferral.

Although we have already urged the OECD to encourage member States to adopt the TRACE Implementation Package, we note that in light of the continuing work on Action 15 (for developing a multilateral instrument to modify tax treaties), the Package contains model language for a multilateral (and bilateral) adoption of our proposed proportional benefits framework by member States. These
thoughtfully drafted model agreements (as well as the model investor self-certification form) can be adopted without the implementation of the “authorised intermediary system” that is the other part of the Package.

Conclusion

If you have any questions regarding any of the information provided above, or if we can provide further information with respect to the application of the limitation on treaty benefits to private investment funds, please do not hesitate to contact Benjamin Allensworth or me at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice-President and Managing Director, General Counsel
Potential Future Nonwidely-Held CIV Structure (assuming MFA proposals adopted)

For Illustration Only

Assume capital is provided 50/50 by Feeder A and B

Some assets held by Master Fund; others held by lower-tier QIAIFs
Dear Sir / Madam,

The NOB (the Dutch Association of Tax Advisors) welcomes the opportunity to provide our comments on the Public Discussion Draft ("PDD") Treaty entitlement of Non-CIV Funds published on 24 March 2016.

It is clear that the OECD is faced with a difficult dilemma. How can tax haven investors be taxed with a fair share of the global tax burden, without hurting the mostly “good” investors behind most non-CIVs with an excessive level of taxation? Denying treaty benefits to non-CIVs will result in double taxation. The resulting accumulation of taxation has all sorts of negative side effects, such as higher costs of capital for businesses which may lead to cancelation of investment plans, diminished returns for pension funds resulting in future cuts in pension payments, reduced income tax revenue in the UBO’s state of residence, re-pricing of assets with dramatic consequences for fund performance, asset valuations and investment/divestment decisions, and expected shifts in investment preferences towards domestic assets. Given these consequences, it is critical that a proper impact assessment is made before reaching a final conclusion on amendment of the rules for non-CIV Funds.

First and foremost, the OECD should think of ways to promote cross border investments in a tax neutral way, whereby each economic agent pays its fair share of tax. Thereafter, the OECD should consider the risks of treaty abuse and necessary steps to curtail such abuse. It is critical that this order is not reversed, with treaty abuse leading the discussion, as this will trigger significant collateral damage among legitimate structures of large global investors, for a small victory in fighting tax evasion of relatively small offshore tax shelters. That is not to say that non-disclosed tax haven assets should not be pursued. Tax avoidance is unacceptable and should be challenged and restricted whenever possible. Our point is that in the pursuit of tax avoidance, we should not lose sight of the bigger picture and the much bigger task at hand, which is securing growth of the global economy.
Non-collective investment vehicles ("non-CIVs") refers to a varied group of investment structures, some may be publicly listed, but most are privately owned. Some of these are owned by a closed group of investors, whereas others have an open character. The majority of ultimate beneficiaries could be qualified as "good" (i.e. treaty eligible) shareholders like pension funds, university endowments, and other (institutional) investors from (mostly) OECD countries. A second important category are state owned entities (SWFs), mostly from the Middle East and Far East. They often qualify as treaty eligible shareholders for most, but not all, investee countries. Non-CIV entities may, however, also have shareholders registered in tax havens or non-treaty jurisdictions. The ultimate beneficiaries may not always be known. Shareholders of these entities should disclose these holdings in their home country tax return, where the income may be subject to current or deferred taxation, subject to the rules of their country of residence. There is, however, an obvious risk that some shareholders do not disclose their foreign shareholdings in their country of residence. We have no knowledge of reliable data detailing to what extent ultimate beneficiaries of non-CIV entities fall in this category, but it is fair to assume that some do. We agree with the OECD that in an ideal world, these "free riders" should be excluded from treaty relief, and should at least suffer the full extent of withholding tax levied by the source countries of the non-CIV’s investments.

Non-CIVs provide an important function in today’s global economy. They provide capital to entrepreneurs and liquidity to the market. It is not uncommon that a fund specializes in a certain industry, country or other topic, and provides not only capital but also expertise. In today’s global environment, non-CIVs have been able to expand their operations globally, and have generally been able to structure their operations in a way that allowed them to access treaty relief. Consequently, double taxation (including capital gain protection) has not been a major impediment to growth. In fact, in some cases, equity contributions could be used to provide loans to local projects. As a general rule, this would improve the return on investment, as local tax would be minimized. Or, external loans could be obtained to increase the gearing and improve the return on investment.

The reason for the industry’s preference for debt funding, is a direct result of the OECD’s own choices. The OECD has always operated under the principle of no or low source-country taxation, so that residence-country taxation rights on passive income are maximized. This principle even pre-dates the OECD, and is based on the 1923 Committee Bruins report\(^1\) of the League of Nations. This report concluded (somewhat conveniently, considering the constituent members), that passive income should be taxed in the state of residence. While this conclusion is understandable for the return on equity (paid out of after-tax income), it is less understandable for payment of interest. The fair share tax principle, applied on a macro level, would argue for a high level of withholding tax on interest, levied by the source country, but only if it was deductible for calculating local taxable income. This would have guaranteed at least one level of taxation (as opposed to the current system that sometimes results in no taxation or minimal taxation). The world would have seen a lot less excessive levels of leverage, had this been the OECD “standard” in its Model Tax Treaty over the past decades.

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When considering changes to the current practice, it is important that the OECD eliminates the mismatch between equity and debt funding, and guarantees a system where taxation is limited to one level (i.e. no accumulation of multiple layers of tax). For instance, an outcome where dividend distributions (and non-deductible interest payments) are subject to zero or low WHT and capital gains are treaty protected, while tax deductible interest payments are subject to high WHT, is perhaps not what investors are hoping for, but is at the end of the day a fair balance and takes away the tax incentive that invited some funds to apply excessive levels of leverage.

The current benign taxation environment for non-CIV structures may change once the OECD and its member countries start applying the conclusions from BEPS 6 to non-CIV structures. As investors select investment opportunities on the basis of their after-tax ROI, it is obvious that increased taxation (withholding tax and capital gain taxation) will lead to a different cost of capital, pricing of assets, and different investment preferences. The main changes one should expect are the following:

1. Global investments would become subject to much higher source country taxation. This would not only shift taxation revenue on passive income from the residency country to the source country, but would also result in a dramatic increase of the tax burden on these investments. This is especially disadvantageous for countries with large pools of investments in overseas assets (e.g. through pension funds).

2. Local investments (or investments close to home) will have a much lower risk of double taxation as there are less border crossings involved. This will result in a different allocation of global capital, resulting in a much bigger focus on domestic investments or straight forward investments closer to home. This necessary shift will be much less disadvantageous for large countries with ample domestic investment opportunities (where returns can be paid free of WHT), than for small countries that are forced to invest overseas. This is also a much larger problem for countries with a large trade surplus which is typically offset by a negative capital account through overseas investments.

3. Since the risk of double taxation will be much higher for equity investments than for debt instruments, funds are likely to develop an even stronger preference for debt funding.

The end result would go directly against the fundamental principles the Organization for Economic Cooperation and Development stands for, as it would impede an efficient international allocation of financial resources (desirable from an investment risk mitigation perspective) and would hamper global trade and the much needed growth of the global economy. The expected changes are very undesirable from a macro economic perspective. They are, however, quite obvious if the OECD elects to take this route.

Applying standard BEPS 6 principles (defined in the LOB and PPT rule of the final report) to non-CIV structures would have the unintended side effect of denying treaty benefits to an investment structure of mostly “good” ultimate beneficiaries, such as pension funds, insurance companies and other institutional investors. Higher source country taxation will result in lower after tax income for these investors. Insurance companies and pension funds are already struggling to make ends meet in today’s environment of suppressed yields engineered by the global central bank policies’ of QE, ZIRP and NIRP. While it is obvious that none of these policies have achieved anything for
“main street”, they have very undesirable side effects, especially for the aging OECD economies, and serve no other purpose than to suppress the interest expense and corresponding budget deficits of OECD governments. It would truly add insult to injury if the OECD proceeded with denying treaty benefits to non-CIV structures that are predominantly owned by pension funds (i.e. retirees of OECD countries), insurance companies and other good investors.

We trust that the authors of the PDD have studied the recently published OECD’s Economic Outlook (February 18, 2016). Like other recent OECD Economic Outlooks, it is again a sobering read, despite its brave effort to give it a positive spin. The bottom line conclusion remains however the same: the OECD is downgrading its predictions for economic growth. IMF’s managing director Christine Lagarde gave a similar message and said in a recent speech that the global economy had lost momentum and that “the recovery remains too slow, too fragile, and risks to its durability are increasing.” She also called on governments to pursue more growth-friendly policies. These negative outlooks should come as no surprise given our demographics (the babyboom generation is past their peak spending years), excessive levels of debt, falling levels of investment, and suppressed interest rates with correspondingly weak bank balance sheets. If there is one message abundantly clear from this dire picture, it is the need for growth, not growth engineered by aspiring central bank helicopter pilots or artificial fiscal stimulation, financed with even more debt borrowed from the future, but real growth based on an unrestricted flow of capital to entrepreneurs with “animal spirits”. If the OECD rule makers decide to stand in the way of this process, they will have nobody to blame for their disappointing results but themselves and overly zealous policies to counter tax evasion.

To prevent any doubt, we are definitely of the view that tax evasion should be rooted out and that every economic agent should pay its fair share of tax. We are fully in support of the OECD’s efforts in this regard. There is however a limit in how far these efforts can go. Unfortunately, reality dictates that economic growth, cross border investment and trade are far more important than catching all tax offenders. There are other policy tools to achieve the latter. The OECD faces the difficult task of striking the right balance between pro-growth tax rules and dissuading tax offenders.

In practical terms, it is important to note that the non-CIVs are an entirely different kettle of fish altogether. Applying standard concepts that may work well for MNCs can easily provide the wrong answer for non-CIV Funds if applied one on one. For instance, an MNC may raise capital via the stock market; its trading platform and clearing mechanism provide liquidity to holders of shares in an MNC. In the case of many non-CIVs, this function is performed by the (often transparent) partnerships and feeder entities structured immediately on top of the fund’s main holding company. The nature of the investors in non-CIVs is different and therefore the structure used to bring suppliers of capital together is also different. In a way, these partnerships, and feeder entities above it, provide the same function as the stock market does for shares in an MNC. It sources the funding of capital and defines the rules for disposition. Consequently, the discussion of treaty protection for non-CIVs should not focus on these (transparent) partnership entities, but should focus on the

2 The Guardian, April 11, 2016
3 McKinsey Global Institute - February 2015: Debt and (not much) deleveraging
holding company directly beneath it. As long as this Fund holding company (i.e. the top tier corporate entity owned directly by the partnership that brings the investors together) has appropriate substance (people with appropriate expertise and experience who are engaged with managing the investment portfolio, or similar significant people functions), treaty protection should be available.

The management of the holding company is for efficiency reasons often outsourced to a separate fund management entity of the Fund provider. The fact that such a holding company does not have any staff on its own payroll but sources this from the provider, should not have any bearing on its rights to claim treaty protection, as long as these functions are carried out in the relevant country and on behalf of the right entity, based on a management services agreement. The same should apply to subsidiary holding companies, incorporated in the same jurisdiction, whether or not consolidated in the same tax grouping or not.

The key to treaty protection should be the nexus with the location of significant people functions (e.g. certain control or risk management functions). If relevant people are based in the fund holding company, treaty protection should be available for such a holding company. Such a holding company is not wholly artificial\(^\text{4}\), but is genuine if these functions are put in place for valid commercial reasons which reflect economic reality\(^\text{5}\). There is no convincing argument to deny treaty protection to such a holding company, especially not on its equity investments (the case for treaty protection on debt instruments is less compelling if interest expense is tax deductible in the source country, see above).

If the OECD is not willing to resolve this issue on the basis of the European standard of “abuse” and treaty eligibility for the non-CIV holding company, some other solution is required. One possible option would be to grant treaty relief to certain qualifying holding companies with a sufficient level of “good” investors. Forcing the non-CIV funds to split into two categories, “good” shareholders and “non-compliant” shareholders, raises many practical issues in how these funds source their funding as well as the secondary market for these investments. Still, for certain closed funds, this may be an acceptable solution. As a general principal however, it is probably not a good idea for taxation requirements to impair the liquidity of a market and the efficient allocation of global capital flows. It would be better if these global capital flows reach their destination based on economic principles, as is currently the case, and incur – on a consolidated basis, i.e. including shareholder level taxation - a level of taxation commensurate with their fair share of the global tax burden.

We all know that tax haven entities are also widely used as feeder entities into non-CIV structures (for the obvious reasons of simplicity, ease of incorporation, adaptation and structuring, and low friction costs in the form of local taxation or otherwise). Some tax haven entities are therefore mere conduits for “good” investors, whereas others have a more troubling origin. The problem is that feeders do not carry a certification guaranteeing that all shareholders have disclosed their holdings in their home jurisdiction. A certification system (e.g. in the form of a shareholder and ultimate

\(^{4}\text{Cadbury Schweppes case (C-169.04)}\)

\(^{5}\text{Compare the general anti-abuse rule recently introduced in the EU Parent Subsidiary-Directive}\)
beneficial owner registry available for global tax authorities and certified by the auditor of the fund is an option the OECD should consider, albeit a difficult one.

Among the tax haven entities with “a more troubling origin” are entities owned by high net worth individuals from countries that provide no or very limited relief to prevent double taxation. Nb. Outside the OECD, there are in fact very few countries that provide decent double taxation relief. The OECD would eliminate much of the current debate if it assisted those non-OECD countries in adopting modern tax legislation that facilitates overseas investments and prevents double taxation. Some efforts are made already, but more is required. Today, the OECD is sitting rather high on its horse when it concludes “that investors may defer recognition of income on which treaty benefits have been granted”. Perhaps a bit too high, as it apparently fails to see that many non-OECD investors would incur full double taxation if they repatriated earnings to their home jurisdiction on a current basis. (Nb. The non-CIV typically distributes earnings on a current basis). Taking the classical taxation system into account (which almost all countries use), this could easily result in a tax burden of 70%-90% on those overseas profits. As long as domestic rules in those countries provide a strong incentive (in the form of double taxation) for non-disclosure, the OECD should help these countries adopt new laws, instead of designing rules that fully deny treaty benefits to non-CIVs because “non-CIV funds may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits,” alleged. The collateral damage to the OECD economies is far too great if treaty protection is denied to non-CIVs with mostly “good” shareholders. If those non-OECD countries can be convinced to adopt modern rules for double tax relief, there will be far less use of tax haven entities as tax shelters. Tax haven entities will still perform a function, but that will be a legitimate commercial function (e.g. as Feeder entity).

Based on the above, we may conclude that in many cases pension rights will need to be reduced if the OECD were to proceed with applying the conclusions from the BEPS 6 final report to non-CIV funds. That will be the inevitable consequence if the OECD loses sight of the bigger picture.

Yours sincerely,
the Dutch Association of Tax Advisers

Helmar Klink
Silvain Nickel
Bartjan Zoetmulder

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\(^6\) Again, we do not condone tax avoidance in any way, but it is important to consider the broader facts, as it changes the priorities.
April 22, 2016

By Electronic Mail

Marlies de Ruiter,
Head, Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development
2, rue André Pascal, 75775 Paris Cedex 16

Dear Ms. de Ruiter:

Re: Follow-up Work on Public Discussion Draft on Treaty Entitlement of Non-CIV Funds

Osler, Hoskin & Harcourt LLP\(^1\) welcomes the opportunity to comment on the OECD Public Discussion Draft, “Treaty Entitlement of Non-CIV Funds” (the “\textit{Discussion Draft}”), published on March 24, 2016, as part of the follow-up work which the final version of the report on Action 6 \textit{Preventing the Granting of Treaty Benefits in Inappropriate Circumstances} (the “\textit{Report on Action 6}”) indicated would be carried on with respect to the policy considerations relevant to the treaty entitlement of non-CIV funds.

Our letter addresses various points raised in the Discussion Draft, including some of the points on which comments were specifically solicited. In particular, our comments focus on the specific questions in the Discussion Draft related to concerns, identified in comments received on previous discussion drafts related to the Report on Action 6, which could affect the treaty entitlement of non-CIV funds. As expressed in the Report on Action 6, governments have expressed concerns about granting treaty benefits with respect to non-CIV funds. More specifically, such concerns include the fact that such funds may be used to provide treaty benefits to investors that are not themselves otherwise entitled to treaty benefits, and that investors may defer the recognition of income on which treaty benefits have been granted.

As a general matter, as is the case with collective investment vehicle (“CIV”) funds, non-CIV funds are crucially important as providers of capital to businesses often located in countries outside of the country in which the relevant fund is based. The benefits arising from tax treaties in facilitating international trade and investment are important and we believe that facilitating international trade and investment should continue to be a

\(^1\) Osler, Hoskin & Harcourt LLP is a leading Canadian business law firm practising nationally and internationally from offices across Canada and in New York. Our clients include pension funds, sovereign wealth funds and the managers of both CIVs and such non-CIV funds as real estate funds, private equity funds and hedge funds.
fundamental goal to be pursued as part of the work under Action 6. International tax rules should not act as an effective barrier to foreign investment. Rather, the features of treaty anti-abuse rules should be carefully crafted with a view to minimizing the potential negative impact on investment into source countries that comes directly or indirectly from investors resident in countries with which that country has a tax treaty.

I. Concerns related to the LOB provision

1. Alternative funds— including private equity funds, hedge funds and venture capital funds, and privately offered mutual funds that are not subject to investor protection regulation and operate much like CIVs but that have largely institutional investors – are all collective investment vehicles through which investors’ capital is pooled and utilized to generate investment returns. Alternative funds often raise money from investors resident in multiple jurisdictions and often invest in multiple jurisdictions. For this reason, the ability of alternative funds to operate effectively cross-border is of key importance to the alternative funds industry, investors in alternative funds and, not least, potential recipients of investment capital.

2. Investors in alternative funds are typically pension funds, charities and educational endowment funds, sovereign wealth funds, insurance companies, banks, other alternative funds and individuals. The ultimate investors or the fund may utilize, for the investments they make, holding companies situated in treaty or non-treaty jurisdictions for a variety of reasons. Some funds will own the shares of one holding company and make all their investments through that company, while others may own the shares of multiple holding companies, with separate companies used for each investment or jurisdiction. Frequently, such holding companies and their ultimate investors are not resident in the same country (particularly when investors may be resident in multiple jurisdictions). However, many of the ultimate investors will often be resident in countries that have tax treaties with the countries in which the fund’s underlying investments are situated (for example, portfolio companies in the case of private equity funds).  

3. In considering the application of LOB rules to alternative funds, we believe it is helpful to take the above into account and also to take a step back and note the

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2 For ease of discussion, we use the term “alternative funds” to refer to various types of non-CIV Funds including private equity funds, but not including sovereign wealth funds or pension funds.

3 Generally speaking, in this letter, where reference is made to an “ultimate” investor or owner that is resident in a country with which the relevant source state has a tax treaty, such investor could be an individual or other entity that is otherwise resident and entitled to benefits under an applicable tax treaty with the source country.
manner in which the issues have been framed when treaty benefits are discussed in a BEPS context. The Action 6 Report places the establishment of entities in a treaty country by third country residents (i.e., so-called treaty shopping) under the rubric of “Cases where a person tries to circumvent limitations provided by the treaty itself”. In the context of most alternative funds – we believe that this is not the case. In particular, applying the OECD’s proposed BEPS rule to investments by most alternative funds could alternatively be viewed as a case “where tax collectors attempt to discriminate against certain treaty residents with a view to denying previously agreed benefits.” In more neutral terms, situations where third country residents invest in a treaty country may be described as a case “where a person tries to satisfy conditions provided by the treaty itself”, or frequently as a case “where residents of multiple treaty countries investing together attempt to maintain the benefits they would otherwise be entitled to if they had sufficient access, scale, etc. to make investments on their own”.

4. Action 6 assumes that the granting or denial of treaty benefits to a treaty resident entity should depend on where its owners are resident. We submit that, having accorded determinative importance to the place where the owners of a treaty resident entity are themselves resident, Action 6 should consistently follow through on the logical and equitable consequences of that approach. Chiefly, this means being open to creative approaches that would allow entities to claim treaty benefits to the extent that their ultimate investors would have qualified for the same or similar benefits.

A. **Suggestion that treaty benefits be granted to regulated and/or widely-held non-CIV funds**

1. In order for the ultimate investors in alternative funds to obtain such treaty benefits as they would have been entitled to had they invested directly in a fund’s holdings, we recommend the following:

   (a) **Derivative Benefits** - Expand the scope of the derivative benefits clause in paragraph 4 of the LOB rule so that it applies to capital gains (and not just dividends, interest and royalties), and so that it applies to regulated and/or widely-held alternative funds, and not just multi-national enterprises, that could make use of it. This would remove the bias against collective investors in the current draft, and would involve such modifications as:

       - allowing trusts and other non-corporate persons to avail themselves of the derivative benefits clause, which currently applies only to “companies”;


• removing the requirement in subparagraph 4(b) of the LOB rule that the number of persons that are equivalent beneficiaries be seven or fewer in number,

• not requiring in the derivative benefits test equivalent beneficiaries to possess above a specified threshold of the “aggregate voting power” in the treaty resident company, since many holding entities utilized by alternative funds may be controlled only by the fund sponsor,

• reducing the derivative benefits test’s ownership threshold from the current proposal (95%) to a number that would accommodate a broader range of funds, while still not being vehicles used to circumvent treaty limitations – such as 75 or 80%, and

• including a “substantially-equivalent beneficiary” concept, whereby a resident of a third state that is eligible for treaty benefits that are substantially similar (but not identical to) those of the treaty being applied could be counted as an “equivalent” investor in determining whether the entity to which the LOB rule is being applied has satisfied the ownership threshold in the derivative benefits test. If this were permitted, the treaty rate applicable to the income of such an entity could be increased through blending with the higher rate applicable to such substantially-equivalent beneficiaries.

(b) If an alternative fund and/or its holding vehicle is directly or indirectly held by investors most of which are equivalent beneficiaries, it should be possible for the alternative fund or holding vehicle, as the case may be, to avail itself of treaty benefits as proposed in respect of CIVs at paragraph 6.27 of the Commentary on Article 1. Alternative funds that fall below such threshold should be granted proportional treaty benefits to the extent its investors are equivalent beneficiaries, as proposed in respect of CIVs at paragraph 6.21 of the Commentary on Article 1. To the extent that the ultimate investors are pension funds or other types of investors that may be entitled to special exemptions from source country taxation, the alternative fund or holding vehicle, as the case may be, should be able to make claims for such exemption on behalf of such investors, as proposed in respect of CIVs at paragraph 6.28 of the Commentary on Article 1.

(c) Consider greater flexibility in determining what counts as “equivalent treaty benefits”, for purposes of identifying equivalent beneficiaries. Our final proposal with respect to testing for equivalent beneficiaries in a non-CIV fund context is best illustrated by an example.
Example: Forco invests in a Canadian company (Canco) that derives its value primarily from immovable property (e.g., a Canadian hotel). Forco is a non-resident corporation, which is in turn owned by a U.S. private equity fund. Substantially all of the investors in the fund are resident in the United States. Forco realizes a capital gain when it sells the shares of Canco, and such gain is exempt from tax in Canada under Article 13 of the Country A-Canada tax treaty because the business of Canco is carried on through the immovable property from which Canco’s value is primarily derived. An equivalent treaty benefit would have been available to the U.S. investors on a sale of Forco shares under Article XIII(4) of the Canada-U.S. Tax Treaty, which is an economically equivalent transaction. As a result, the investors or the fund should be considered equivalent beneficiaries under any anti-treaty shopping rule.

Because tax treaties may have different conditions for eligibility for treaty benefits, and because there may be multiple ways in which transactions can be structured, consideration should be given to conceiving of the equivalent beneficiary concept in a manner that takes into account economically similar transactions/structures.

(d) Consider greater “look-through” treatment in identifying equivalent beneficiaries. The various existing tests for treaty benefit entitlement that take equivalent beneficiaries into account – for instance, CIV-specific rules in the Commentary to Article 1 and the proposed derivative benefits rule in the Action 6 Report – reflects, we believe, a serious and unfair disadvantage in terms of allowing alternative fund structures to obtain treaty benefits. The CIV-specific rules that test for ownership by equivalent beneficiaries look only to direct ownership. While the proposed derivative benefits test in the Action 6 Report tests indirect, as well as direct, ownership by equivalent beneficiaries it provides that each intermediary owner must itself be an equivalent beneficiary. Consideration should be given in all cases to allow equivalent beneficiary ownership thresholds to be satisfied through indirect ownership without requiring intermediate owners to be treaty residents. Many non-CIV funds (for example, hedge funds formed as Cayman Islands companies) and the holding companies used by non-CIV fund investors or by non-CIV funds may not themselves be equivalent beneficiaries. However, where the ultimate owner is an equivalent beneficiary, the investment returns are ultimately being included in income by an investor that is “liable to tax” under a treaty with the applicable source country. If the OECD is
concerned that this will allow potential deferral opportunities or allow treaty benefits to be claimed in structures where there is intermediation by tax haven entities, we submit that such concerns could adequately be addressed through domestic controlled foreign corporation (“CFC”) rules and anti-deferral rules applicable to investments in non-controlled investment/passive entities. Tax treaties should not be used as a blunt instrument to deny benefits in cases of the potential deferral of tax. Rather, countries should be free to adopt targeted domestic rules to prevent any abusive deferral opportunities. In particular, where the ultimate investors in non-CIV funds are exempt from tax there should be no concern with respect to tax deferral.

2. The Discussion Draft notes that a number of commentators have suggested that an exception to the LOB rule should be provided for “regulated widely held funds”. In particular, any special rules provided for CIV funds could also be provided to an alternative fund. (As noted above, derivative benefit rules would still be required to ensure that treaty benefits are not denied simply because a fund makes an investment through a holding company that provides the same or similar benefits to what would have been available if the relevant investors or the relevant fund had invested directly.) The following discussion sets out the manner in which an alternative fund could be considered to be regulated or widely held.

(a) **Regulation** - If treaty benefits are to be provided to a CIV fund on the basis that it is regulated in a particular jurisdiction then similar treaty benefits should be allowed to a non-CIV fund that is subject to similar regulation. Attached as Appendix A is a discussion illustrating the similarities between how two recognized common CIV and non-CIV funds (mutual funds and large private equity funds) are regulated in the United States.

(b) **Widely-held** - If treaty benefits are to be provided to a fund on the basis that it is “widely held” then the applicable threshold could be set at an objective level (such as at least 100 investors each holding equity interests in the fund with a value of at least US$500).

3. A comprehensive approach to ensuring that treaty benefits are accorded only in appropriate circumstances to CIVs and alternative funds, as well as holding entities used by such funds, would build on the recommendations in the 2010 CIV report\(^4\). The goals of Action 6 and of tax treaties generally would be best served

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in many circumstances by combining the various approaches and broadening their scope to apply to non-CIV funds.

B. Suggestion that the LOB rule include a derivative benefit rule applicable to certain non-CIV funds

1. Our comments on this item are included above as part of our comments on the application of the LOB clause to non-CIV funds.

II. Concerns related to the PPT rule

1. The PPT rule, which is framed in terms that are open-ended (and therefore will likely be applied inconsistently across member states), has the potential to create considerable uncertainty with respect to the availability of treaty benefits for CIVs and non-CIV funds in circumstances where treaty benefits are one of the considerations taken into account in making an investment. The practical reality is that investors will consider the anticipated tax consequences in virtually every investment decision. Accordingly, there is a significant risk that the PPT rule will be applied inconsistently and result in significant tax disputes.

2. If a PPT rule is to be adopted in a particular treaty, we believe that it is important for the OECD to set out clear guidance in advance with respect to the circumstances in which CIV or non-CIV funds (including their holding entities) may be entitled to treaty benefits. In particular, the broad wording of the PPT rule in the Report on Action 6 could allow ambiguity with respect to whether treaty benefits apply in virtually any investment. This is clearly undesirable, as funds may not be able to make significant investment decisions based on the anticipated after-tax returns to their investors. Such uncertainty could discourage large providers of cross-border capital from making foreign investments. Certainty, predictability and fairness are important tax policy goals that must be followed.

3. A degree of certainty, predictability and fairness could be provided through additional examples or safe harbours illustrating common situations in which a PPT rule will not apply. For example, a rebuttable presumption that the PPT rule does not apply could be added where any of the following conditions are satisfied: (i) an investment would otherwise satisfy an LOB rule, (ii) the majority of the ultimate investors would otherwise be entitled to similar treaty benefits if they had made the relevant investment separately (rather than collectively), (iii) the relevant investment fund is regulated and/or widely held, (iv) an expanded derivative benefits rule applies, or (v) similar conditions are satisfied.
4. The current examples provided in the Report on Action 6 create undue confusion by suggesting treaty benefits may be denied in even the most straightforward situations. Example D in the Report on Action 6 relates to a CIV that is 80% owned by investors in the same country and makes a minority investment in another country. This example should be clarified to state that it would be only in extremely unusual circumstances that a fund having sufficient equivalent beneficiary investors would be used for the type of treaty abuse to which the PPT rule is directed. Moreover, an example should be provided if there is in fact a situation in which such an investment should be caught by the PPT rule.

If you have questions or would like further information regarding any of the points discussed above, please contact Patrick Marley (pmarley@osler.com) and/or Matias Milet (mmilet@osler.com).

Yours very truly,

Osler, Hoskin & Harcourt LLP
Appendix A

There are many similarities in the manner in which various countries regulate certain CIV and non-CIV funds. By way of illustration, the following discussion compares the manner in which the United States regulates various mutual funds and large private equity funds (“LPEFs”).

In the United States, mutual funds, arguably the most pervasive type of CIVs, are principally governed by the Investment Company Act while the managers of LPEFs are generally required to be registered as investment advisers under the Investment Advisers Act. The Investment Company Act and the Investment Advisers Act (collectively, the “Acts”) follow a common regulatory approach with respect to transparency and investor protection. The differences in the scope of regulation contemplated by each Act are generally attributed to the characteristics of the typical investor in the relevant investment vehicle.

Both the Investment Advisers Act and the Investment Company Act require managers of LPEFs and mutual funds, respectively, to periodically disclose certain information publicly to foster transparency. An investment adviser subject to the Investment Advisers Act, including the managers of a LPEF, must file a Form ADV to register with the U.S. Securities and Exchange Commission (the “SEC”). This form must be updated at least annually, and more often as necessary to disclose material changes. A new mutual fund must file Form N-1A with the SEC in order to register under the Investment Company Act, and Forms N-Q and N-SAR must be filed periodically by mutual funds to ensure that investors have access to current information about the fund. While the disclosure requirements of Form ADV for LPEF managers are not as expansive as the disclosure requirements for mutual funds, the principal topical areas of

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5 Investment Company Act of 1940, 15 U.S.C. §80a, et seq. (2016). Mutual funds also are governed by the Securities Exchange Act of 1934, the Securities Act (as defined below) and the Investment Advisers Act (as defined below).

disclosure are similar. For instance, information must be provided by LPEF managers and mutual funds regarding the business, fees, relationships and background of managers and other personnel, business practices, principal risks and certain financial conditions. Additionally, LPEF managers and mutual funds are required to keep the disclosed information current, and each must update for material developments or changes. In each case, the information is publicly accessible to investors electronically via the SEC’s website. LPEF managers’ information is available on the Investment Advisers Information Depository (IARD), and mutual fund reports are available through the SEC’s Electronic Data Gathering, Analysis and Retrieval (EDGAR) system.

Additionally, both LPEF managers and mutual funds must make certain disclosures to clients and investors, as the case may be, under the relevant Acts. Under the Investment Advisers Act, LPEF managers are required to deliver to each current and potential client a “brochure” that includes, among other things, background on the adviser’s business practices, principal risks, management strategies, potential conflicts of interest and all material information regarding compensation. Similarly, mutual funds must maintain a current prospectus that provides investors with information on the fund, its operations, investment objectives and strategies, performance, risks and fees. Although the specific disclosure requirements for a mutual fund are more extensive than those applicable to a LPEF manager, the fundamental principle of providing sufficient information to facilitate an informed investment decision, as well as the primary categories of required disclosures and the mechanisms for disclosure, are similar.

There are other parallels between the core principle of investor protection underlying the securities law regimes governing LPEF managers and mutual funds. For example, LPEF advisers and advisers to mutual funds each have fiduciary duties to their...

7 See Rule 204-3 under the Investment Advisers Act. Often the brochure is identical to Part 2 of Form ADV.

client funds and must, among other things, (i) manage client accounts in the best interests of the client, (ii) have a reasonable basis for providing investment advice, (iii) adequately disclose all material facts to clients, including any material conflicts of interest, and (iv) seek to execute client transactions as favorably as possible to the client. The general partner of a LPEF and the board of a mutual fund also have fiduciary duties of care and loyalty to investors under U.S. state partnership or corporate laws, as applicable. Additionally, both LPEF managers and mutual funds are required under the respective Acts to establish compliance programs reasonably designed to prevent violations of the U.S. federal securities laws, including policies and procedures to prevent the misuse of material, non-public information.9 LPEF managers and mutual funds each must appoint a chief compliance officer to implement and enforce their respective compliance programs.10 Furthermore, LPEF managers and mutual funds must (i) adhere to certain restrictions on the custody of the relevant fund’s assets, (ii) satisfy certain prohibitions on fraudulent or misleading advertising and (iii) comply with restrictions on transactions with affiliates.11 The Acts also require that both LPEF managers and mutual funds maintain extensive books and records, and the SEC has discretion to make periodic or special examinations of the books and records of both LPEF managers and mutual funds.12

Although there are some notable differences in the regulatory regimes applicable to LPEF managers and mutual funds, the type of investor that typically invests in each

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9 See e.g., Rules 204A-1 and 206(4)-7 under the Investment Advisers Act and Rule 38a-1 under the Investment Company Act.

10 See Rule 206(4)-7 under the Investment Advisers Act and Rule 38a-1 under the Investment Company Act.

11 See Section 206 of the Investment Advisers Act and Rules 206(4)-1 and 206(4)-2 thereunder, Sections 17(a), 17(d), 17(e), 17(f) and 10(f) of the Investment Company Act and Rules 17d-1 and 10f-3 thereunder and Section 5 of the 1933 Act.

12 See Section 204 of the Investment Advisers Act and Rule 204-2 thereunder and Section 31 of the Investment Company Act and Rules 31a-1 and 31a-2 thereunder.
vehicle helps to inform the applicable level of regulation. Typically, LPEFs are marketed to sophisticated investors who command the negotiating leverage necessary to protect their own interests in LPEF documentation, which often contains provisions requiring the LPEF to furnish additional periodic information about the LPEF and its investments, and a requirement to provide annual audited financial statements, to investors. However, the Investment Company Act contemplates more rigorous requirements for mutual funds, requiring additional disclosures to mutual fund investors concerning investment strategy and portfolio composition, daily valuations of mutual fund assets and certain diversification, leverage and liquidity requirements. This may be, in part, because mutual funds tend to attract more retail investors than LPEFs, and these investors may lack the requisite negotiating power to procure additional investor protections in mutual fund documentation. Accordingly, LPEF managers may be subject to less stringent regulation more generally under the Acts given LPEF investors typically are more sophisticated and, therefore, arguably require fewer statutorily-mandated investor protections.

Given the substantial similarity in the principles governing the transparency and investor protection-related provisions of the Acts, LPEFs and mutual funds should be treated similarly for tax treaty purposes, and accordingly, LPEFs should be subject to the same exemptions from the OECD Model tax treaty abuse policies and provisions as CIVs.

13 See Sections 5(b) and 18(f) under the Investment Company Act and Rules 2a-7 and 22c-1 thereunder.

14 To satisfy the relevant securities law exemptions, most LPEFs mandate that their investors be “accredited investors” under the Securities Act and “qualified purchasers” under the Investment Company Act. See U.S. Securities and Exchange Commission, Report on the Review of the Definition of “Accredited Investor” (December 18, 2015).
On behalf of the Public Affairs Executive (PAE) of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

Re: Response to OECD Consultation on Treaty Entitlement of non-CIV Funds

Introduction:

The European private equity industry\(^1\) is pleased to respond to the above-mentioned consultation. In line with our commitment to finding a suitable solution to the question of treaty access for private equity funds, we have now responded to all 4 OECD Action 6 consultations with the submission of this paper.

As outlined in the consultation document, we will only be responding to those questions which are relevant for the European private equity industry as they are connected to points we made previously in our OECD BEPS Action 6 submissions.

**SUGGESTION THAT TREATY BENEFITS BE GRANTED TO REGULATED AND/OR WIDELY-HELD NON-CIV FUNDS**

1. What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

For example, in order for a fund to be considered widely held a fund would need to have 20 different investors with no single investor providing more than 10% of the aggregate investor commitments.

2. What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

Different jurisdictions have put in place their own regulatory frameworks for non-CIVs. In this response we focus on the regime in place in the European Union, whilst recognising

\(^1\) The term private equity is used to refer to both private equity and venture capital. The term venture capital is used in specific circumstances when there are particular characteristics which relate to that asset class.
that in other parts of the world the local regulatory framework will determine the appropriate prudential requirements in a manner consistent with local circumstances.

The EU Alternative Investment Fund Managers Directive (AIFMD)\(^2\) would be acceptable in order to conclude that a fund is regulated for the purposes of such a proposal. The AIFMD entered into force on 22 July 2013 in the European Union. It regulates the management and marketing of alternative investment funds in the European Economic Area. The objective of this Directive is to create a comprehensive and effective regulatory and supervisory framework for Alternative Investment Fund Managers (AIFMs) at European level.

AIFMs are required to obtain authorisation and are subject to on-going regulation and supervision. In this way, the AIFMD aims to:

- Increase the transparency of AIFMs towards investors, supervisors and the employees of the companies in which they invest;

- Equip national supervisors, the European Securities & Markets Authority (ESMA) and the European Systemic Risk Board (ESRB) with the information and tools necessary to monitor and respond to risks to the stability of the financial system that could be caused or amplified by AIFM activity. Even though, as the De Larosière Report into the causal effects of the financial crisis noted, the private equity industry was not a contributing factor;\(^3\)

- Increase the accountability of AIFM holding controlling stakes in companies towards employees and the public at large, and

- AIFMs are required to inform competent authorities about their use of leverage at fund level, so that the authorities can assess whether the use of leverage by the AIFM contributes to the build-up of systemic risk in the financial system. This information is shared with the ESRB. Where the use of leverage deployed by an AIFM poses a substantial risk to financial stability supervisors have the power to intervene.

The AIFMD introduces safeguards to ensure that investors in alternative investment funds, who are mainly professional or semi-professional, are well informed and adequately protected. For example, the AIFMD requires that:

- Conflicts of interest are avoided or managed and disclosed;

- AIFMs employ adequate systems to manage risks to which the fund is exposed, and to ensure that the liquidity profile reflects the obligations towards investors;

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\(^2\) Alternative Investment Fund Managers Directive 2011/61/EU

\(^3\) Report of the High-Level Group on Financial Supervision in the EU chaired by Jacques De Larosière, February 2009
• A fund’s assets are safe-kept, or monitored, by an independent depositary subject to a high liability standard;

• Valuation is performed properly and independently; and

• Strict conditions are met when AIFM delegates functions to third parties.

Depending on the type of Alternative Investment Fund (AIF) they manage, an AIFM with assets under management amounting to less than €500 million (for unleveraged funds with long 'lock-in' periods) or €100 million for other types of alternative investment fund will be subject to a tailored regime. These AIFMs will be required to register with national authorities and comply with harmonised transparency requirements, as well as additional requirements applied at national level.

The AIFMD also provides for the possibility for these sub-threshold AIFMs to ‘opt-in’ so as to avail of passporting rights in return for full compliance with the AIFMD. Therefore, while not all fund managers will be subject to the AIFMD regime, due to the size thresholds that recognise their specific risk characteristics, the vast majority of EU-based private equity fund managers are regulated (authorised or registered) under the Directive.

Funds and managers in other jurisdictions will have their own regimes that address many of the same issues that are covered by the AIFMD in a manner consistent with local circumstances. In some cases these may be very similar to AIFMD (e.g. in those jurisdictions that have expressly decided to mirror the EU regime in order to facilitate access to an EU marketing passport).

3. Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

As a general point, this question imposes a presumption of wrongdoing on non-CIV funds and their managers. Providing a thorough and comprehensive rebuttal of the potential wrongdoing identified in the question is quite difficult as it is akin to proving a negative. Nevertheless, we believe that we can demonstrate the high degree of unlikelihood that these practices are commonly taking place.

Existing due diligence procedures (such as the requirements under CRS, FATCA and Anti-Money Laundering legislation) already offer an efficient means of ensuring that private equity funds are not used to provide treaty benefits to investors who are not themselves entitled to treaty benefits.

Before admitting an investor into the fund, the fund must comply with several specific due diligence procedures regarding the status of the potential investor. If we take an example
of a French private equity fund, pursuant to Articles L. 561-2 et seq. of the French Monetary and Financial Code (Code Monétaire et Financier), which implements domestic provisions on the fight against money laundering and the financing of terrorism, a fund manager must:

- assess the risks of money laundering and financing of terrorism; and
- verify, as far as possible, the identity of each investor and the effective beneficial owner of the investment in the private equity fund.

Each investor must complete an anti-money laundering and anti-financing of terrorism questionnaire and provide all necessary information including:

- constitutive documentation in respect of such investor;
- a declaration made by the investor in relation to the determination of the nature and the provenance of any funds invested;
- an annual report; a certificate of incorporation or registration;
- (where applicable) a copy of any relevant passports or identity documentation;
- a list of effective beneficial owners;
- and a declaration and supporting evidence regarding the residence of any effective beneficial owners.

These existing due diligence procedures on the status of a private equity fund’s investors - carried out to the greatest extent possible by the private equity fund manager upon the creation of the fund and before acceptance of the subscription of an investor - already offer an efficient means of ensuring that private equity funds are not used to provide treaty benefits to investors who are not themselves entitled to treaty benefits.

The LOB test threatens the private equity industry’s ability to make these investments. It risks discriminating against private equity if investing into this asset class is treated differently than direct investment into the same types of asset. It also introduces significant additional compliance costs that reduce the return to investors and / or the capital available to support and grow businesses. Private equity fund managers already devote time and resources to carry out due diligence on their investors and have invested significantly in systems to comply with FATCA and to be CRS-ready. But these existing regimes (the anti-money laundering rules, FATCA and CRS) find an appropriate balance between the compliance burden placed on financial institutions and the need to mitigate the particular risks with which the regimes are concerned. For example, if an investor in a private equity fund is itself FATCA-compliant, the private equity fund does not need to make any further report in relation to it. Similarly, the focus of most national anti-money laundering laws is on identifying the beneficial owners of those investors with a stake of 25% or more. As set out in our previous submissions, satisfying the LOB test would be significantly more onerous for a widely held non-CIV fund than complying with these existing regimes.
4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

There is a strong commercial imperative inherent in private equity fund models to distribute quickly. It is important for investors to be able to manage cash flows effectively, which also impacts the ability to better manage the funding risk of their investment. In this regard, deferring distributions would not be helpful to investors and it would negatively impact the internal rate of return (the ‘IRR’) they achieve.

The result of this financial model is that the fund manager will make its best efforts to ensure that the fund distributes to its investors as soon as practical the amounts received from realised investments. In any case, as private equity fund structures are most often tax transparent and many investors are tax exempt, any deferral of distributions would not necessarily result in any tax deferral. There are, of course, instances where distributions are affected by meeting costs of the transaction, repaying loans and re-investing proceeds.

A private equity fund as such cannot be used to defer recognition of income. The OECD’s concern for investors in non-CIVs is thus a separate question of investors and their tax status in their respective locations. The debate should not be misconstrued in the framework of the treaty benefits of fund structures.

5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

Firstly, we disagree with the assertion that an exception from the LOB rule for a widely-held fund should be more generous than the exception already provided for publicly-listed companies.

As included in the final Report on Action 6 from October 2015, publicly-traded companies and entities would satisfy the LOB if:

(i) a company’s principal class of shares is regularly traded on one or more recognised stock exchanges; and

(ii) the company’s or entity’s primary place of management and control is in the Contracting State of which it is a resident; or at least 50 per cent of the aggregate voting power and value of the shares (and at least 50 per cent of any disproportionate class of shares) in the company or entity is owned directly or indirectly by five or fewer companies or entities entitled to benefits under subdivision i) of this subparagraph, [provided that, in the case of indirect
ownership, each intermediate owner is a resident of either Contracting State).\(^4\)

In our view, the equivalent criteria for non-CIVs would be for the fund to be regulated and widely held. As we have demonstrated above, private equity funds are regulated. As we will demonstrate below under question 8, private equity funds are widely held. We believe it is inaccurate therefore to conclude that an exception for non-CIVs should be “more generous” than the exception for publicly-listed companies. Objectively, such an exception for non-CIVs would be providing equal treatment rather than special treatment.

We would also like to highlight the significant concerns that the European Commission has with the operation of the LOB, as currently drafted. In its Anti-Tax Avoidance Package (ATAP) which was released in January, the European Commission, through both hard-law and soft-law measures, is attempting to implement several of the OECD BEPS standards in the EU in a uniform fashion. According to the Chapeau Communication of the ATAP, the Commission explains that:

“[I]ssues relating more to tax treaties have not been included in the Directive. Nonetheless, a coordinated approach is needed now to prevent negative spill-overs. The Commission is therefore presenting a Recommendation on the implementation of measures relating to Permanent Establishments, as well as to the G20/OECD report on Tax Treaty abuse. In this context, the Commission is concerned that the G20/OECD report includes Limitation of Benefits clauses as an option, although it is acknowledged that this may not be appropriate in all regions. These clauses limit the benefits of tax treaties to entities owned by residents of only one Member State, and therefore can be seen as detrimental to the Single Market by discouraging cross border investment. These rules can be problematic for the Capital Markets Union.”\(^5\)

The accompanying Recommendation then provides guidance to EU Member States on how to implement the PPT in an EU-law compliant manner.\(^6\)

6. One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

Intermediaries such as special purpose vehicles are commonly used by private equity funds.

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\(^4\) Preventing the Granting of Treaty Benefits in Inappropriate Circumstances ACTION 6: 2015 Final Report, Section A, pp. 26

\(^5\) European Commission, Communication from the Commission to the European Parliament and the Council, Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU, 28 January 2016, pp. 6

\(^6\) European Commission, Commission Recommendation of 28.1.2016 on the implementation of measures against tax treaty abuse, 28 January 2016,
The legitimate use of intermediaries is acknowledged in the OECD 2010 Report: “CIVs thus act as both issuers of securities and investors in securities. As a result, there may be layers of intermediaries both below the CIV (i.e. between the issuer of the security in which the CIV is invested and the CIV), and above the CIV (i.e. between the CIV and the beneficial owner of the interests in the CIV). In many cases, those intermediaries will not be located in the country in which the issuer is located and may not be located in the country in which the investor is located.”

The OECD 2010 Report acknowledges the difficulty for CIVs in identifying the ultimate investors in the fund: “[t]he difficulty in tracing of course also is compounded by the fact that interests in CIVs frequently are held through layers of intermediaries. In those cases, the CIV’s records will show the names of the intermediaries through which the investors hold their interests in the CIV, rather than the names of the investors themselves.”

As further explained in the consultation document:

“[A] key practical difficulty in the application of the transparent entity provision to non-CIV funds is that it requires that the State of source be provided with all the relevant information concerning the investors in the non-CIV. The same practical difficulty would arise with respect to any approach under which the treaty entitlement of a non-CIV would be related to the treaty entitlement of all, or a high percentage of, the investors in that non-CIV. A number of commentators indicated that at least some types of non-CIV funds may be unable to identify the tax residence of their investors despite the evolving requirements of anti-money laundering legislation and tax reporting regimes. Examples that were provided were that of a securitisation company which “may not be in a position to identify who its bondholders are”, a fund of funds and “where a financial institution invests in a collective investment scheme on behalf of its own clients or for the purposes of structured investments which it sells to its own clients”. One commentator suggested that even solutions based on the principles of the TRACE project would not offer a practical solution for private equity funds.”

Indeed, the private equity industry emphasised that the TRACE project would not be suitable for private equity funds for these reasons.

The intermediate holding company structures used by private equity funds should not disadvantage such funds in their tax treatment as the structure is not designed to facilitate tax avoidance. Rather, they serve to prevent the tax distortion and barriers to investment that exist under the current laws, due to the lack of global harmonisation of the treatment of entities used in fund structures and are used for other non-tax reasons to meet the needs of investors. They allow a fund to invest in an asset on the same level as other

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7 OECD THE GRANTING OF TREATY BENEFITS WITH RESPECT TO THE INCOME OF COLLECTIVE INVESTMENT VEHICLES2010 Report, 23 April 2010, pp. 6
8 OECD Public Discussion Draft, Treaty Entitlement of non-CIV Funds, 24 March 2016, pp. 6
investors in that asset. They can facilitate access to tax treaty provisions for investors in the fund without those investors having to make treaty claims individually. They can also provide practical benefits such as allowing participation in shareholder meetings and votes, and making the conclusion of contracts more straightforward.

Holding companies in certain jurisdictions can ensure that fund investors are afforded greater certainty regarding insulation from legal liabilities that might flow out of a domestic structure to non-domestic parents. This matter is particularly relevant where shareholder consent outside of the investee jurisdiction is given, or entities are deemed to be subject to a controlling parent which can give rise to liabilities arising in the controllers’ hands. An intermediate holding jurisdiction can often provide the only meaningful shield to these risks.

During its life-cycle, it is impossible for the private equity fund to take into account the tax status of each of its ultimate investors when the fund manager decides the structuring of the fund’s investments, as to do so would create significant conflict of interest issues given the different tax situations of investors. In addition, there is no universal rule on the tax transparency of a private equity fund. As a result, the investee countries may refuse (i) to recognise the tax transparency of a fund that is established in another country and (ii) the tax residence of the fund as it is not subject to tax. This has the effect of denying treaty relief to treaty eligible investors.

For these reasons, a private equity fund invests through one or more wholly-owned holding companies. There is no doubt that these holding companies have a real business substance because they are the financial pillars of the investment made by the fund. In order to benefit from the protection of tax treaties, a private equity fund generally arranges the governance within the holding companies so that the decision that these companies make are taken locally at their level. In addition, to strengthen the limited liability of investors in the fund (which is a key criterion for the investors), it is advised to have a strict distinction between the management of the fund localised at the level of the fund manager.

A private equity fund cannot and does not attempt to structure its investments to be tax efficient for each investor. Whilst it is relatively simple for certain types of corporate groups (closely held company with a limited number of investors) to deal with the different tax attributes of group members, that possibility is not available to a private equity fund as in many cases it will not have access to full information regarding the underlying nature and tax treatment of the investors. For private equity funds, whilst the tax treatment at the intermediary holding company level can be ascertained, they are most unlikely to have thorough information as to the tax treatment of the ultimate beneficial investors.

Generally speaking, private equity funds make equity investments and debt investments. The normal exit is to sell their equity and debt investments after five years or more. In addition, the investment by the fund is usually made with third-party debt financing (e.g. mezzanine debt, senior bank debt). In such a context, a private equity fund cannot make investments without creating an interposed wholly-owned holding company in order to
make its investments and also to locate the mezzanine debt and the senior bank debt.

8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

In our previous responses to Action 6 consultations, we provided detailed information on who the investors into private equity funds are. We are happy to elucidate this information here again. In 2014, the investors into European private equity funds were the following:
This information is contained in the Invest Europe Yearbook.  

As can be seen from the illustration below, the investors into European private equity are located all over the world, with a significant proportion being located outside the EU. The choice of location for the private equity firm as well as for the funds managed and/or advised by the firm is normally made on the basis of various factors (residence of the management team, investment strategy, regional or national investment focus, addressed investor base, access to advisory infrastructure, stable and predictable tax and legal environment, etc).

The investors in a typical private equity fund will usually consist of numerous, globally dispersed investors. On average a private equity fund has 7 different types of investors (e.g. pension funds, sovereign wealth funds, etc as listed on the previous page in the graphic) and a typical fund might have dozens of individual investors. These investors are either subject to (corporate) income tax in their country of residence (insurance companies, family offices), or are exempt from such tax by their nature (pension funds, charities).

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

The OECD 2010 Report states that for the purposes of the Report, “the term “CIV” is limited
to funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established.”\textsuperscript{11} In the 2\textsuperscript{nd} consultation on Action 6, the OECD stated that non-CIVs do not share these characteristics with CIVs. In our response to that consultation, we demonstrated that this assertion was wholly inaccurate.\textsuperscript{12} We would like to reiterate that non-CIV is not somehow the opposite of CIV. In the EU, we generally do not use the term non-CIV, instead using the term alternative investment fund, as per the AIFMD, which is explained above under Question 2.

Although “alternative investment fund” captures a wide variety of funds, some may infer from this that there is uniformity between these funds that simply does not exist. The range of fund types under the AIFMD family is quite diverse and private equity funds are one type that exists within the wide framework. While there may be certain similarities between some private equity structures and structures used by other fund types, private equity funds are quite different from many of the fund types found under the AIFMD umbrella, such as hedge funds, as they neither issue securities that can be traded nor do they themselves trade in securities on a regular basis.

What are commonly referred to as private equity funds in reality take many different shapes and form, ranging from the unitized fund structures seen in many European jurisdictions, and which are governed by the relevant fund laws, to co-investment arrangements typically in the form of negotiated limited partnership agreements (e.g. English or Delaware) governed by civil law. In France for example, private equity structures are usually FPCIs or FPSs that can have legal personality. These structures are not in the scope of French income tax or corporate tax and as a result, they are not considered as tax resident entities and cannot automatically benefit from the tax treaties which other Member States have signed with France.

To be more precise, what are referred to as private equity funds are, in the majority of cases not funds as legally defined by fund law but rather co-investment arrangements organized in limited partnership or other form. Investors who put their capital into listed shares and bonds do so in order to diversify risk and build portfolios of assets. In doing so, they are taxed once in their home jurisdictions for capital gains or dividend income, etc. Institutional investors also want to invest into unlisted companies of all sizes in different sectors. But as these companies are much harder to find, analyze, value and manage, these institutional investors prefer to invest together with a partner that has that expertise in this area, along with the added benefit of risk-sharing and rewards. While doing these co-investments in an organized and negotiated form, these investors are still conscious of the principle of being taxed once in their home jurisdiction, just as if they had held the underlying unlisted shares directly and in the same way as holding listed shares.

Thus, the structure chosen for this type of co-investment needs to be tax-neutral and

\textsuperscript{11} Supra 7, pp3.

\textsuperscript{12} Invest Europe\textsuperscript{, Response to OECD BEPS 2nd Consultation on Treaty Abuse (Action Point 6), January 2015}
transparent. It is only a means of organizing these investments more efficiently with the specialized partner taking the management responsibility. Ideally, one would use the limited partnership structure and the negotiated agreement setting out the rights and responsibilities of the different partners. In jurisdictions where the limited partnership structure can create risks of permanent establishment for any of the investors or is otherwise not feasible, special vehicles have been developed over the years to guarantee this tax neutrality like limited liability companies or special funds and other vehicles. The purpose here is to organize one’s investments into unlisted companies in as efficient way as possible while ensuring that the investor is only subject to taxation in their home jurisdiction.

Questions related to the identification of the investors in a non-CIV

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

The ownership of interests in a non-CIV fund does not change frequently like the interests in a typical collective investment fund. The limited partnership agreement drawn up between the manager and investor will stipulate exactly under what conditions the investor may sell their stake in the private equity fund in the secondary market. The inclusion of such restrictions on the sale of units/shares in a private equity fund is essential in order to guarantee the fund’s long-term nature and avoid a situation whereby investors may be unable to meet capital calls issued by the fund manager.

The exact conditions for sale of a stake in a private equity fund on the secondary market will vary between different limited partnership agreements. But, for example, it is typical that in an English limited partnership no sale of a partnership interest may be made without the consent of the General Partner and the number of sales permitted in a 12 month period is limited. The typical private equity fund will be self-liquidating with a defined term, and will have investors who each make a significant investment with the intention of holding that investment until maturity, and most will in fact hold until maturity.

Global data shows that the volume of transactions on the secondary market was in the region of 40 billion dollars in 2015. 13

14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

The specific tax status of many ultimate investors is something that the fund is unable to control or influence and, in many cases, ascertain due to investors investing via funds of funds and other indirect methods. The legitimate use of intermediary vehicles is addressed above under question 6.

13 Greenhill Cogent, Secondary Market Trends & Outlook, January 2016
As addressed under question 4 on deferral of income above, as soon as the fund divests the assets, that return on capital will be distributed to the investors in the fund. At this point, the taxation of those returns in the hands of the investors is an issue which is beyond the reach of the fund manager. It would be illogical, in our view, to penalize those non-CIVs which perform a legitimate capital-channelling function simply because there is a potential that the investors into those funds may not be fully tax compliant on a standalone basis in their particular jurisdictions. As demonstrated above under our answer to question 3, this potential is significantly mitigated by the fund manager’s due diligence requirements.

Although a significant percentage of investors in certain fund structures are entitled to relief in their own right by making a claim through a double tax treaty if they were a direct investor, administratively it is far more efficient that they receive the correct return in the first place without having to resort to treaty claims. This is especially so if the investor is tax exempt like most pension funds. In this case, the tax levied becomes a de facto cost as there is no tax levied in the investor’s home jurisdiction against which this tax can be offset. This is also an issue where withholding tax is applied to interest income and dividends or more importantly, capital gains tax is levied on non-resident investors.

Should the fund manager take on the role of processing tax reclaims on behalf of investors, then it will still involve increased resources and costs, thereby reducing returns. It will also mean that there could be a significant delay in some investors receiving all the proceeds due to them as the processing of repayment claims by tax authorities can be slow (sometimes taking years, rather than days). Without an intermediary holding company, funds could also be exposing their investors to local tax filing requirements, which is not the aim of Action 6 nor the BEPS project overall. Even where all the investors are entitled to relief in their own right, inconsistencies in the tax treatment of commonly used fund entities can still create barriers to obtaining relief in practice. There is also a risk that if fund managers are obliged to take on a tax claim-processing role then they may chose to start excluding certain investors from their funds which would be very detrimental to the investors.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

The management of a non-CIV fund will have the standard information on those persons who hold interests in the fund, as per the CRS standard. This information includes all relevant financial income including interest, dividends, along with information on account balances and sale proceeds from financial assets.

The management of a non-CIV fund will not have the same information on any further beneficiaries of those legal persons for the reasons explained in our answers to previous questions.

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not,
what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

No, this information is not currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly. Some information may be available to the private equity fund but not the entirety as some investors will be funds of funds (as mentioned above) and therefore the available information as to the investor will be restricted to this point. Even if the information were to be available to the private equity manager in this instance, such details will be confidential and thus not transferable beyond the confines of the legal relationship between the ultimate beneficial owner and its counterparties. While not representative of the majority of private equity funds, some funds will be open-ended or listed and in these circumstances the difficulties indicated above will be exacerbated as clearly it will be almost impossible to obtain information around a changing investor base. As indicated above, private equity investors are spread across the globe and it is simply impossible to understand each investor’s tax position.

The OECD 2010 Report acknowledges this same issue for CIVs – “[t]he difficulty in tracing of course also is compounded by the fact that interests in CIVs frequently are held through layers of intermediaries. In those cases, the CIV’s records will show the names of the intermediaries through which the investors hold their interests in the CIV, rather than the names of the investors themselves.”

The barriers that exist, as addressed in our previous response, is that investors invest in private equity funds via indirect means and as such there is usually no contractual relationship between fund and ultimate investors.

Yes, intermediate ownership does present obstacles to obtaining information about ultimate beneficial ownership.

Questions related to the prevention of treaty-shopping

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

14 Supra 7, pp. 15
This question appears to be a combination of questions 3 and 6, simply phrased differently.

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

It is clear to us that the determination of whether ultimate investors into non-CIVs are entitled to access tax treaties is a difficult question to resolve from a policymaker’s perspective. We have demonstrated, through examples and statistics, that the structure and rationale of private equity funds significantly minimises the possibility for these funds to be used to grant treaty benefits to those investors who would not otherwise be entitled to such benefits. Nevertheless, the OECD has not accepted these submissions.

In order to avoid disadvantaging the private equity industry and disrupting the vital cross-border flow of capital to the real economy which private equity funds provide, the European private equity industry is now suggesting an approach which will allow tax authorities to evaluate the treaty eligibility of investors without imposing additional burdens on private equity funds and their managers.

The European private equity industry believes the most optimal solution would be a test whereby a fund - which certifies that at least 50% of its direct and indirect investors are comprised of investors that would otherwise be eligible for treaty benefits in their own right - would be eligible for treaty benefits. In other words, we propose that private equity funds and their subsidiary holding companies be eligible under the LOB Rule for the benefits of a particular treaty to the extent that a fund is able to certify that at least 50% of its direct and indirect investors are comprised of pension funds and other tax-exempt investors, governmental entities or instrumentalities and their controlled subsidiaries, and investors that would otherwise be eligible for the benefits of the applicable treaty in their own right, and/or other private equity funds (such as funds of funds) that satisfy the requisite ownership threshold in their own right (collectively “Eligible Investors”). While this approach is informed by the inclusion of a derivative benefits provision in the Final Report, it is intended to be applied as a separate exception from the LOB rules.

For purposes of certifying whether a fund satisfies a minimum 50% Eligible Investor ownership threshold to qualify for treaty benefits, the fund and its sponsor should be entitled to rely on certifications that the investors provide regarding their status as Eligible Investors for purposes of an applicable treaty. Under this approach, a private equity fund or its sponsors would obtain a certification from each of its investors as to the jurisdictions for which such investor is an Eligible Investor, possibly under new draft OECD US W8-BEN equivalents. The fund or the sponsor, on behalf of the fund, would then provide an appropriate certification as to the fund’s eligibility for treaty benefits under a particular treaty each time benefits are sought by the fund based upon the self-certifications received by the fund from its investors. We similarly believe that such an approach should also be
applied to any fund of fund that invests in a non-CIV.

While private equity funds would be required to track the reported Eligible Investor status of its direct investors across the jurisdictions in which the fund is investing, such funds would not be required to act as a withholding agent or otherwise be required independently to verify the status of its indirect beneficial owners through multiple tiers of ownership. We believe that such a reporting protocol will help to alleviate concerns of treaty shopping, while balancing the administrative and practical realities that many private equity funds encounter, as described in greater detail in our earlier comments.

The 50% threshold that we propose is influenced by the exemption for publicly-listed entities and our belief that equivalent treatment should be available to different means of investing (as explained above under question 5) so as to avoid any distortion of investor decisions. We acknowledge the difficulty that policymakers face in determining an appropriate threshold. In our view, a 50% threshold test for funds that are widely held and regulated is appropriate as these are the equivalents to the characteristics under the publicly listed exemption of being traded on a regulated platform and ownership held at least 50% by entities entitled to benefits. Nevertheless, in line with our commitment to finding a final workable outcome on this topic, we are willing to engage constructively on determining an alternative appropriate threshold that would be proportionate for granting treaty access and would not distort investor choice.

If the OECD deems that this approach is not suitable, then we envision that a further approach could be possible. This would be based on the principle that private equity fund managers will continue to provide national competent authorities with the information on investors stipulated under CRS & FATCA. National competent authorities will then use that information - potentially in conjunction with further reporting information granted by those immediate investors themselves – in order to identify exactly who the ultimate investors are and subsequently, what their tax treaty eligibility is. At that point, the relevant national competent authorities will be able to delineate between the investors who are eligible in their own right to treaty benefits, and those who are not. Those investors who are eligible will receive the appropriate tax credits, while those who are not would receive the appropriate tax bill.

This approach would differentiate between the fund and its investors. The fund and associated structures would continue to access tax treaty benefits while any illicit tax treaty access by investors would be dealt with at the investor level. As stated above, it would be illogical, in our view, to penalize those non-CIVs which perform a legitimate capital-channelling function simply because there is a potential that some investors into those funds may not be fully tax compliant on a standalone basis in their particular jurisdictions.

We believe that if the tax authorities were to take this approach, then the vast majority of ultimate investors into private equity will satisfy the treaty tests of their own accord. It is for this reason that we feel confident to suggest such an approach.

19. One of the proposed requirements for the application of the suggested derivative
benefits rule would be a 50% base erosion test. Since one of the main concerns expressed by governments relates to the possible use of non-CIV funds for treaty-shopping purposes, wouldn’t the 50% threshold proposed for the base erosion test be too generous?

We would like to highlight our response to question 5 where we analyse the publicly-listed company exemption which is based partially on a 50% beneficiary ownership test.

20. According to the proposal, acceptable ultimate beneficial owners would include persons who would “include their proportionate share of the fund’s income on a current basis”. How would a State of source be able to determine when this requirement is met? Also, what would be considered an acceptable anti-deferral regime? In particular, would a regime under which a taxpayer is taxed on a deemed amount of income or deemed return on investment be considered as an anti-deferral regime even if the amount that is taxed is significantly lower than the actual return? Would the United States PFIC regime be an example of an acceptable anti-deferral regime?

We would like to highlight our response to question 4 where we deal with the issue of deferral of income.

**ADDITIONAL EXAMPLES FOR THE COMMENTARY ON THE PPT RULE**

25. Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

**Proposed company owned non-CIV fund PPT example:**

A non-CIV fund, which could take any legal form, including a partnership, is a ‘financial institution’ resident for these purpose in a jurisdiction that is participating in the CRS and/or FATCA regimes, and has not been categorised as a ‘non-participating financial institution’ for any such purposes. This non-CIV fund will make a number of investments and will make them, or some of them, through one or more companies, likely to be resident in a jurisdiction with a range of double tax treaties.

The company or companies used have been put in place for administrative efficiency and simplicity, to centralise any treaty claim process, and/or to avoid issues that commonly arise given the inconsistent recognition of the tax transparency or tax status of fund vehicles across different jurisdictions.

The company and the non-CIV fund distribute almost all income remaining after tax and expenses to investors. The company pays tax in its country of residence on any non-distributed income.

The non-CIV fund has a geographical and/or sector oriented investment strategy, which is central to the investors’ decision to invest. The investors’ decision to invest is not driven by
any particular investment made by company and the investment strategy of the non-CIV fund is not controlled by investors.

Investors in the non-CIV fund are identified and categorised for CRS and/or FATCA purposes and provide any information required to enable the non-CIV fund to comply with its obligations under the regimes applicable to it. Each investor that is itself a financial institution is resident for these purposes in a jurisdiction that is participating in the CRS and/or FATCA regimes, and has not been categorised as a ‘non-participating financial institution’ for any such purposes.

On the basis of the information above, the majority of investors are tax exempt (including pensions funds, charities or sovereign wealth funds) and/or are resident in jurisdictions which have treaties with the countries in which investments are made reducing or eliminating withholding in a similar way (and/or are themselves ‘financial institutions’ resident for these purpose in a jurisdiction that is participating in the CRS and/or FATCA regimes, which have not been categorised as a ‘non-participating financial institution’ for any such purposes), but a minority may be resident in non-treaty states.

The fact that in making the decision as to where to locate the company or companies in question the non-CIV considered the terms of any applicable double tax treaty is insufficient to trigger the PPT.

**Conclusion:**

Private equity funds are not in the business of treaty shopping. The primary purpose of private equity, just like other CIVs, is a business purpose, i.e. the co-investment arrangement or pooling of capital to make investments. As long as different countries’ interpretations of what constitutes a permanent establishment are not harmonised across the globe, tax treaty access will remain crucial in order to achieve tax neutrality for funds, and to avoid double or even triple taxation in genuine bona fide investment structures.

The private equity industry fully appreciates the concerns of the OECD that action is needed to effectively prevent double non-taxation, as well as cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it. We also support a proportionate international approach to tackle these important issues.
Contact

Thank you in advance for taking our comments into account as part of the consultation process. We would be more than happy to further discuss any of the comments made in this paper.

For further information, please contact Danny O’ Connell at Invest Europe (formerly known as the European Private Equity & Venture Capital Association (EVCA)).

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About the PAE

The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.

About Invest Europe

Invest Europe is the association representing Europe’s private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe’s leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members’ role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry’s professional standards, demanding accountability, good governance and transparency from our members.

Invest Europe is a non-profit organisation with 25 employees in Brussels, Belgium.

For more information, please visit www.investeurope.eu
Re: Comments on the BEPS Consultation Document on the Treaty Entitlement of Non-CIV Funds

Dear Sir or Madam:

The Private Equity Growth Capital Council (the “PEGCC”) is pleased to submit these comments on the BEPS Consultation Document on the Treaty Entitlement of Non-CIV Funds released by the OECD on 24 March 2016 (the “Consultation Document”). The PEGCC, based in Washington, DC, is an advocacy, communications and research organization established to advance access to capital, job creation, retirement security, innovation, and economic growth by promoting long-term investment. In this effort, the PEGCC develops, analyzes and distributes information about the private equity and growth capital (together, “private equity”) industry and its contributions to the U.S. and global economy. For further information about the PEGCC and its members, please visit our website at www.pegcc.org.

On 5 October 2015, the OECD published its final report in respect of the OECD/G20’s BEPS Project Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances (the “Final Report”). The Final Report includes a number of recommendations aimed at curtailing treaty abuse, including incorporating into treaties (i) limitation-on-benefits provisions that would limit the availability of treaty benefits to certain “qualified persons” within the relevant jurisdiction (the “LOB Rule”) and (ii) a more general anti-abuse rule based on the principal purpose of transactions or arrangements (the “PPT Rule”). Prior to the release of the Final Report, the PEGCC submitted comments to the OECD in January 2015 and June 2015 in response to public discussion drafts issued by the OECD in connection with its work on Action 6.1

While the Final Report recommends the treatment of certain collective investment vehicles ("CIVs") as “qualified persons” for purposes of determining treaty entitlement, the OECD working group has determined that further evaluation continues to be necessary regarding appropriate treaty entitlements of non-CIV funds. The two general concerns described by the OECD working group in the Final Report and the Consultation Document in relation to granting treaty benefits to non-CIV funds are: (i) that such funds may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits and (ii) that such funds may provide an opportunity for deferral of income recognition by investors in respect of income on which treaty benefits have been granted.

We take comfort in the OECD working group’s important acknowledgement of the economic importance of non-CIV funds, and the need to ensure that treaty benefits are granted to non-CIV funds in appropriate circumstances. We continue to believe, however, that the concerns described in the Final Report and the Consultation Document are misplaced with respect to private equity funds and their investors. Private equity funds provide investors with an efficient means of accessing global investment opportunities. To perform this function, private equity funds must be able to afford investors tax neutrality in respect of the capital invested through such funds. Investors that pool and deploy capital through private equity funds should be in no worse an economic position than such investors would have been in had such investors invested directly in the underlying portfolio company. We believe that an approach that inappropriately restricts the ability of private equity funds to access treaty benefits and provide their investors tax neutrality could have a chilling effect on the ability of private equity funds to attract and deploy significant amounts of capital for global investment. Therefore, while we welcome the OECD working group’s continued thoughtful evaluation of treaty entitlements of non-CIV funds more generally, we urge the OECD working group to adopt an approach that treats private equity funds in parity with CIVs by providing for a separate category of “qualified persons” under the LOB Rule covering private equity funds and their subsidiary holding companies.

In the event, however, that the OECD working group is unwilling to recommend that private equity funds be treated as “qualified persons” under the LOB Rule, we would support an approach whereby private equity funds that are widely held or that are subject to substantial regulatory oversight and their subsidiary holding companies either be treated as CIVs or as a separate category of “qualified persons” for purposes of the LOB Rule. Section III.A below discusses criteria that we believe are appropriate for evaluating whether a private equity fund is widely held or subject to substantial regulatory oversight. Furthermore, in such event, we would also support the alternative mechanism discussed in Section III.B below. This mechanism is intended to grant treaty benefits to funds that do not satisfy the widely held or regulatory oversight criteria described in Section III.A so that such funds and their subsidiary holding companies are not inappropriately denied treaty benefits. Under this alternative mechanism, a fund would be eligible for treaty benefits if it certifies that at least 50% of its direct and indirect investors are pension funds, sovereign wealth funds, other governmental entities or instrumentalities and/or investors that would otherwise be eligible for treaty benefits in their own right. We believe, however, that this alternative mechanism should be applied only in cases where a fund does not otherwise satisfy the widely held or regulatory oversight criteria described in Section III.A below.
The PEGCC does not believe that either the inclusion of a derivative benefits provision in the LOB, as currently proposed, or the “Global Streamed Fund” regime (the “GSF regime”) outlined in the Consultation Document is an appropriate or feasible alternative for providing private equity funds and their investors with access to treaty benefits. As discussed in more detail in Section IV below, the proposed GSF regime raises significant practical and administrative concerns for private equity funds.

Finally, we have included as an appendix to this letter our responses to specific questions posed by the OECD working group in the Consultation Document. The responses included in the appendix summarize our comments below as well as certain comments included in our prior comment letters.

I. Private Equity Funds are Not Vehicles for Treaty Shopping or for Deferring the Recognition of Income by their Investors

As a threshold matter, private equity funds do not present the treaty-shopping and deferral of income recognition concerns identified with regard to non-CIV funds in the Final Report and the Consultation Document. As described in greater detail in our prior comment letters, private equity funds are closed-end investment vehicles formed for the purpose of pooling capital of a broad base of investors and investing that capital in portfolio companies. These funds are not established to facilitate tax avoidance and do not retain low-taxed or untaxed pools of capital at the fund level. Private equity funds share many of the characteristics of other CIVs as described in the OECD’s 2010 report on The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles. Similar to CIVs, private equity funds generally have a broad investor base, invest in a broad range of jurisdictions and industries, and are subject to substantial regulation.

Private equity funds promote cross-border investment and provide investors with an efficient means of deploying capital for investment across jurisdictions. These investors include corporate pension plans, public retirement plans, foundations, university endowments, sovereign wealth funds, insurance companies, banks and, to a lesser extent, high net worth individuals and family offices. Such investors often would be exempt from tax as a result of their status and/or otherwise entitled to treaty benefits in their own right if they were to invest directly in the underlying investments of the fund.

As discussed in more detail in our June 2015 comments, private equity funds are organized most frequently as fiscally-transparent limited partnerships in order to achieve tax neutrality and the flow-through of the characteristics of the underlying income realized by the fund. Each fund investor is subject to tax, to the extent applicable, on its proportionate share of the fund’s profits. Private equity funds have a limited investment period in which they are permitted to make investments. A private equity fund may form one or more subsidiary holding companies that
make these investments.\(^2\) The investment holding period for a particular private equity fund investment, however, is generally between three to seven years prior to exit. During this time, subject to limited exceptions, private equity funds generally are not permitted to reinvest capital. Rather, proceeds received by a fund or a subsidiary holding company in connection with a disposition of an investment generally are required to be distributed promptly to investors. Private equity fund sponsors are incentivized to ensure that such distributions of investment proceeds are made promptly to investors because retention of uninvested capital would reduce investment returns. Accordingly, these structures do not provide the opportunity for taxable investors to defer tax.

II. Private Equity Funds Generally Have a Broad and Diverse Investor Base and are Subject to Extensive Regulatory Regimes

As described in more detail in our January 2015 comments, private equity funds share many of the characteristics of CIVs as described in the OECD’s 2010 report on *The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles*. The 2010 CIV report defines CIVs as “funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established.” Like CIVs, private equity funds generally have a broad investor base, with any particular fund having a large number of direct and indirect beneficial owners. The governing documents of private equity funds often include provisions requiring such funds to satisfy certain diversification requirements in respect of their investment portfolios. In addition, as described in our January 2015 comments, private equity sponsors and their funds are subject to substantial regulation. Although the regulation of the marketing, management and operation of private equity funds and/or their advisers or sponsors varies from jurisdiction to jurisdiction, regulation focused on investor protection is typically quite extensive.

III. Status of Private Equity Funds for Purposes of the LOB Rule

The PEGCC strongly believes that its comments in relation to the discussion draft preceding the Final Report continue to be relevant to the OECD working group’s evaluation of appropriate treaty entitlements of non-CIV funds. Private equity funds are not vehicles for treaty shopping, nor are such funds designed to provide deferral of income recognition for investors. Private equity funds serve an important role of pooling capital from a broad investor base to facilitate cross-border investment. In order to continue serving this important role, private equity funds

\(^2\) Private equity funds typically do not hold interests directly in portfolio companies. Instead, a fund will organize one or more subsidiary investment entities to acquire and hold these interests. These subsidiary investment entities may be formed for a number of different commercial purposes, including providing liability insulation for the fund, facilitating financing arrangements in connection with an underlying investment and satisfying local legal requirements. Subsidiary investment entities are not used to facilitate tax avoidance, and granting such entities treaty benefits affords investors in a private equity fund tax neutrality in respect of capital invested through the fund in comparison to a direct investment in a portfolio company.
must be able to afford investors tax neutrality in respect of the capital invested through these funds.

An LOB Rule that inhibits the ability of private equity funds to access treaty benefits creates a significant barrier for funds and their investors. The PEGCC continues to believe that a properly tailored application of the PPT Rule is a better method of addressing these concerns with respect to private equity funds, as opposed to the LOB Rule, which would substantially and inappropriately limit the ability of private equity funds to provide investors tax neutrality in respect of capital invested in these funds. Moreover, for the reasons stated in our June 2015 comment letter, we do not believe that the inclusion of a derivative benefits provision in the LOB Rule, as currently proposed, effectively addresses the concerns we have raised in respect of treaty benefit access for private equity funds. Therefore, the PEGCC continues to believe that, as a policy matter, private equity funds should be treated in parity with CIVs and that the LOB Rule should include a category of “qualified persons” that covers private equity funds and their subsidiary holding companies.

In the event, however, that the OECD determines not to support the inclusion of private equity funds as “qualified persons”, the PEGCC would support the treatment of private equity funds and their subsidiary holding companies that are widely held or that are subject to substantial regulation as CIVs (and, therefore, as “qualified persons”) for purposes of the LOB Rule. We have summarized below certain criteria that we believe would be appropriate for determining whether a particular private equity fund should be treated as meeting these two requirements. For funds that do not satisfy either the widely held or regulatory oversight criteria described below, and in the absence of a broad inclusion of private equity funds as “qualified persons”, we believe an alternative mechanism could be employed to ensure that such funds and their subsidiary holding companies are not inappropriately denied treaty benefits. Under this alternative mechanism, a fund would be eligible for treaty benefits if it certifies that at least 50% of its direct and indirect investors are pension funds, sovereign wealth funds, other governmental entities or instrumentalities and/or investors that would otherwise be eligible for treaty benefits in their own right.

Contrary to the recommendations of the PEGCC and other commenters that the PPT Rule apply in cases where “the principal purpose” of an arrangement or transaction is inappropriately obtaining the benefits of a tax treaty, the OECD working group has included in the Final Report a more subjective PPT Rule that applies in cases where “one of the principal purposes” is inappropriately obtaining the benefits of a tax treaty. The PEGCC continues to believe that this more subjective standard may lead to varying interpretations across jurisdictions of the same set of facts and circumstances and may create uncertainties in determining how a particular jurisdiction could apply the PPT Rule. The PEGCC welcomes the OECD working group’s continued evaluation of the examples submitted by the PEGCC and other commentators last year regarding inappropriate applications of the PPT Rule, and encourages the OECD working group to release further guidance on the specific application of the PPT Rule in light of these examples.
A. **Private Equity Funds that are Widely Held or Subject to Substantial Regulation**

1. **Widely Held.** Private equity funds typically have a large number of direct and indirect beneficial owners, a substantial majority of which are exempt from taxation in their own right (e.g., by virtue of a domestic law exemption for pension plans or other tax-exempt investors or as a result of sovereign immunity applicable to foreign governments and their controlled entities) or that would qualify for the benefits of a treaty. We believe that a private equity fund should be treated as widely held for purposes of determining eligibility under the LOB Rule if such fund and its related fund entities have, in the aggregate, 20 or more different direct investors, with no single investor representing more than 10% of the aggregate investor commitments to such fund and its related fund entities.

For purposes of determining whether a particular private equity fund (together with any of its subsidiary holding companies) is widely held, we believe that any interests held by investors in related fund entities should be taken into account. Often, private equity funds are composed of multiple partnerships or other entities formed to accommodate the specific regulatory or other needs of particular investors. For example, it is not uncommon for private equity sponsors to form limited partnerships or other entities that invest in parallel in underlying investments in proportion to the investors’ commitments to each fund vehicle. These “parallel funds” are often formed to accommodate specific regulatory, legal or other commercial considerations in respect of certain groups of investors. In addition, a private equity sponsor may establish a “feeder fund”, organized as a separate limited partnership or other entity that, in turn, invests in the main fund. Interests held by investors in parallel funds, feeder funds and other related fund entities, should be taken into account for purposes of evaluating the investor composition of a particular private equity fund and determining whether such fund is widely held.

2. **Subject to Substantial Regulation.** U.S.-based and European-based private equity sponsors and their funds are subject to substantial regulation, regardless of the jurisdiction in which a fund is organized. We have included below a detailed discussion of certain of the regulatory requirements that govern private equity sponsors and their funds. These requirements provide broad investor protections, governing how and to whom private equity funds may be marketed and managed. These regulatory requirements also govern more generally the conduct of private equity sponsors vis-à-vis their investors. For example, as described below, sponsors and their funds typically are required to undertake a comprehensive verification process to ensure that fund investors are, in fact, eligible to participate in such funds in accordance with the applicable regulatory requirements. Given the comprehensive and substantial regulatory regime governing private equity sponsors and their funds, and the particular focus on investor protections, we believe that private equity sponsors and their funds that are subject to either of the U.S. or European regulatory regimes described below should be treated in parity with CIVs for purposes of the LOB Rule.

   (a) **U.S. Securities Laws.** Private equity sponsors and their funds are subject to a robust regulatory regime, focused on investor protection, under the U.S. federal securities laws. In the United States, private equity funds, the marketing of interests in private equity funds to investors, and the activities of their sponsors (advisers) and their placement agents are subject to extensive regulation under the U.S. federal securities laws, including the
antifraud provisions thereof. The most relevant statutes are the U.S. Securities Act of 1933 (the “Securities Act”) (offer and sale of fund interests), the U.S. Securities Exchange Act of 1934 (the “Exchange Act”) (placing activity and the secondary market), the U.S. Investment Company Act of 1940 (the “Investment Company Act”) (funds and qualification of investors in private funds) and the U.S. Investment Advisers Act of 1940 (the “Advisers Act”) (operations and activities of fund sponsors and general partners).

More specifically, the marketing of interests in private equity funds is predominantly conducted under the private offering exemptions of the Securities Act and, in particular, Rule 506(b) of Regulation D of the Securities Act. This rule, among other things, (i) prohibits a fund from engaging in a general solicitation (e.g., public advertising) and (ii) permits a fund to offer to an unlimited number of “accredited investors”4 and up to 35 non-accredited investors who have such experience in financial and business affairs as to be able to evaluate the merits and risks of the offering. A fund relying on Rule 506(b) is required to make a filing with the SEC disclosing the offering on Form D. In addition, Rule 506(d) of Regulation D under the Securities Act prohibits a fund from relying on Rule 506 to conduct its offering if the fund or certain related persons (e.g., the general partner, the sponsor, the placement agent and 20% beneficial owners) have committed certain “bad acts” (e.g., criminal convictions and violations of anti-fraud provisions).

The marketing of private equity fund interests is also subject to the antifraud provisions under the Securities Act and the Exchange Act, including Rule 10b-5 under the Exchange Act which prohibits (i) engaging in any act that operates as a fraud or deceit in connection with the purchase or sale of a security and (ii) making any untrue statement of a material fact or omitting to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading.

For sales of interests in most U.S. private equity funds, the Investment Company Act requires that (i) the fund does not offer its securities in a public offering and (ii) either (a) its outstanding securities (other than short-term paper) are beneficially owned by not more than 100 persons (excluding certain “knowledgeable employees”)5 or (b) all of the beneficial owners of its

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4 Accredited investors” generally are (i) certain regulated entities (e.g., banks, insurance companies, registered broker-dealers, and registered investment companies), (ii) certain U.S. state pension plans or employee benefit plans with more than $5 million in assets, (iii) certain legal entities with more than $5 million in assets, (iv) any director, executive officer or general partner of the issuer of the securities being offered or sold (or of the general partner of that issuer), (v) any natural person with an individual net worth, or joint net worth with that person’s spouse, exceeding $1 million (excluding that person’s primary residence), (vi) any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person’s spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year, (vii) any trust with total assets in excess of $5 million and (viii) any entity in which all of the equity owners are accredited investors.

5 A “knowledgeable employee” is generally (i) an executive officer, director, trustee, general partner, advisory board member or a person serving in a similar capacity of the private fund or the private fund’s investment adviser (or certain of the adviser’s affiliates) and (ii) an employee of such entities who, in connection with his or her regular
securities (excluding certain “knowledgeable employees”) are “qualified purchasers.” A non-U.S. private equity fund is prohibited from offering its securities to U.S. persons unless it satisfies the conditions in clause (ii) above with respect to its U.S. beneficial owners.

Moreover, U.S. investment advisers (which term includes private equity fund sponsors and general partners that control private equity funds) to private equity funds and other alternative investment funds are regulated under the Advisers Act. A U.S. private equity fund sponsor generally would be required to register as an investment adviser with the U.S. Securities and Exchange Commission (“SEC”) under the Advisers Act if it has more than $150 million in private fund assets under management. An investment adviser registered with the SEC is required (i) to adopt and implement a compliance program administered by a chief compliance officer reasonably designed to prevent violations of the U.S. federal securities laws, (ii) to adopt and implement a policy protecting material non-public information (e.g., to prevent insider trading) and to adopt a code of ethics that requires the reporting of personal securities transactions by certain persons and (iii) to maintain a range of books and records. The SEC staff conducts examination of registered investment advisers to review the effectiveness of the adviser’s compliance program, the adviser’s books and records and the adviser’s compliance with the substantive provisions of the Advisers Act.

In addition, a private equity fund sponsor that is registered with the SEC is required to file and update a Form ADV and, if the sponsor has more than $150 million in private fund assets under management, a Form PF. Form ADV is divided into three parts: (i) Part 1A requires general identification and financial information about the adviser and its business, including whether it maintains custody of client assets and information regarding the disciplinary history of the adviser and its employees, and information on private funds managed by the adviser, including information on their structure, their assets, the categories of their beneficial owners and their service providers; (ii) Part 2A of Form ADV requires an adviser to describe, in narrative form, its advisory services, fees and compensation, types of clients, methods of analysis and investment strategies (and related risks), disciplinary information, material relationships with other financial industry participants, certain of the adviser’s policies and procedures with respect to compliance matters, brokerage practices, custody arrangements, proxy voting practices, any financial condition that is likely to impair the adviser’s ability to meet its contractual commitments to its clients (and, in certain circumstances, an audited balance sheet) and potential conflicts of interest with clients; and (iii) Part 2B of Form ADV provides information about the educational background, business experience and disciplinary history (if any) of the supervised persons who provide advisory services to the client. Form PF is designed to allow the SEC and other financial functions or duties, participates in the investment activities of such entities (and who has been performing substantially similar functions or duties for at least 12 months).

6 A “qualified purchaser” is generally (i) a natural person with $5 million or more in investments, (ii) a family company with $5 million or more in investments, (iii) a trust whose trustees and grantors are all qualified purchasers, or (iv) a legal entity with $25 million or more in investments.
regulators to assess the systemic risks related to private funds and the frequency and level of
detail required by Form PF depend on the adviser’s assets under management relating to private
funds and the types of private funds the adviser manages. A large private equity fund sponsor is
required to provide information about, among other things, the performance, categories of
investors, and leverage of its funds and the leverage of their portfolio companies.

The antifraud provisions are at the heart of the Advisers Act and make it unlawful for any
investment adviser (i) to employ any device, scheme, or artifice to defraud any client or
prospective client or (ii) to engage in any transaction, practice, or course of business which
operates as a fraud or deceit upon any client or prospective client. The Advisers Act’s antifraud
provisions have been interpreted to impose on the adviser an affirmative duty of utmost good
faith to act solely in the best interests of its clients and to make full and fair disclosure of all
material facts, particularly where the adviser’s interests conflict with those of its clients. A
private fund sponsor is also subject to a general antifraud rule (Rule 206(4)-8) that prohibits
conduct that defrauds investors or prospective investors in pooled investment vehicles managed
by the investment adviser. An investment adviser is required to identify and, if necessary,
mitigate and/or disclose any conflicts of interest that it, its affiliates or its employees have with
its clients, including, among other potential conflicts, with respect to the allocation of investment
opportunities and the allocation of fees and expenses. The SEC has adopted a number of rules
under the antifraud provisions of the Advisers Act governing, among other things,
advertisements, the custody of client assets, the use of client solicitors, political contributions and
proxy voting.

Most placement agents (or certain other persons who are in the business, for compensation, of
marketing securities, including interests in private equity funds, to investors) offered in the
United States for private funds are required to be registered as a broker-dealer with the SEC
under the Exchange Act. A registered broker-dealer is also generally required to become a
member of the Financial Industry Regulatory Authority (“FINRA”), a self-regulatory
organization responsible for, among other things, issuing rules for and conducting examinations
of registered broker-dealers and their representatives. FINRA rules, among other things, impose
restrictions on the marketing materials provided by placement agents with respect to private
funds.

Additional U.S. federal and/or state statutes and rules regulate, among other things, (i) anti-
corruption and bribery concerns (e.g., the U.S. Foreign Corrupt Practices Act), (ii) anti-money
laundering and sanctions compliance, and (iii) investor privacy and identity theft with respect to
the activities of U.S. persons, including U.S. alternative investment fund sponsors and their
affiliates.

(b) AIFMD. European sponsors of private equity funds are subject to
substantial, comprehensive and robust regulation as a consequence of the implementation of the
European Union Alternative Investment Fund Managers Directive (the “AIFMD”). In summary,
the AIFMD regime requires a European sponsor to hold significant regulatory capital, to have in
place detailed policies that deal with matters such as risk management, conflicts of interest and
remuneration and to disclose information on a regular basis to its regulator, its investors and, in
certain cases, portfolio companies and their employees. The AIFMD also extends to non-
European sponsors that wish to market their private equity funds in Europe. In addition to other matters, a non-European sponsor must satisfy the disclosure obligations that apply to European sponsors. The AIFMD also contemplates that non-European sponsors marketing in Europe ultimately will be subject to equivalent regulatory requirements to those that apply to European sponsors.

B. Substantial Portion of Tax-Exempt, Government or Treaty Qualified Investors

In the event that a private equity fund does not satisfy the criteria for being treated as widely held or subject to a substantial regulatory regime, as described above, we believe a more narrowly tailored approach could be adopted for granting treaty benefits to such funds in appropriate circumstances. Specifically, we propose that private equity funds and their subsidiary holding companies should be eligible under the LOB Rule for the benefits of a particular treaty to the extent that a fund is able to certify that at least 50% of its direct and indirect investors (based on aggregate investor commitments) are comprised of pension funds and other tax-exempt investors, governmental entities or instrumentalities and their controlled subsidiaries, and investors that would otherwise be eligible for the benefits of the applicable treaty in their own right, and/or other private equity funds (such as funds of funds) that satisfy the requisite ownership threshold in their own right (collectively “Eligible Investors”). While this approach is informed by the inclusion of a derivative benefits provision in the Final Report, it is intended to be applied as a separate exception from the LOB Rule.

We believe that, for purposes of certifying as to whether a fund satisfies a minimum 50% Eligible Investor ownership threshold to qualify for treaty benefits, the fund and its sponsor should be entitled to rely on representations that the fund’s investors provide regarding their status as Eligible Investors for purposes of an applicable treaty. Under this approach, a private equity fund or its sponsors would obtain representations from each of its investors as to the jurisdictions for which such investor is an Eligible Investor. The fund or the sponsor, on behalf of the fund, would then provide a self-certification as to the fund’s eligibility for treaty benefits under a particular treaty each time benefits are sought by the fund based upon the representations from its investors. While private equity funds would be required to track the reported Eligible Investor status of its direct investors across the jurisdictions in which the fund is investing, such funds would not be required to act as a withholding agent or otherwise be required independently to verify the status of its indirect beneficial owners through multiple tiers of ownership. We believe that such a reporting protocol will help to alleviate concerns of treaty shopping, while balancing the administrative and practical realities that many private equity funds encounter, as described in greater detail in our earlier comments. We would be happy to provide assistance in developing a suitable form of self-certification that could be provided by private equity funds under this approach.

IV. Global Stream Fund Regime

The PEGCC does not believe that the GSF regime outlined in the Consultation Document is an appropriate or feasible alternative for providing private equity funds and their investors with access to treaty benefits and ensuring tax neutrality in respect of invested capital. Under the proposed GSF regime, a private equity fund that elects to be treated as a GSF would be required
to (i) distribute 100% of its income and realized gains currently to its investors and (ii) withhold tax on distributions to its investors (other than other GSFs) based upon the applicable treaty entitlements of such investors in respect of the source of the underlying proceeds giving rise to the distribution and (iii) remit such withheld tax to its state of residence for further remittance to the state of source of the underlying proceeds.

This proposal raises significant practical and administrative concerns for private equity funds consistent with the practical and administrative issues that arise in applying the LOB Rule to these funds. As we have commented previously, private equity funds may have hundreds of investors and these investors often invest through tiered entities, including other funds. Private equity funds often make investments in numerous different jurisdictions, each with different treaty rules. For fund investors that do not elect to be treated as GSFs, identifying the ultimate beneficial owners of interests in a fund implicit in such an approach, including interests that are held indirectly through upper-tier entities, and their treaty entitlements in respect of each jurisdiction in which the fund invests would require a level of inquiry that is substantially beyond what is required by currently applicable regimes, including the U.S. FATCA rules. This inquiry would require access to information with respect to indirect investors that the private equity fund may not be able to identify and with which it has no legal relationship.

It will often be impractical, if not impossible, for a fund to determine the treaty entitlements of each of its investors in respect of all sources of income of the fund and effectively act as a withholding agent in respect of such income. Even if this level of inquiry were feasible as a practical matter, it would be a time consuming and daunting process, particularly for funds with large numbers of investors, and would impose substantial additional compliance costs upon funds and their investors. We do not see how such a proposal alleviates in any way the practical, administrative and policy considerations raised by us and other commentators with regard to the granting of treaty benefits to non-CIV funds.

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We would welcome the opportunity to discuss any of the points raised in this letter with you.

Respectfully submitted,

Jason Mulvihill
General Counsel
Private Equity Growth Capital Council
APPENDIX

SUGGESTION THAT TREATY BENEFITS BE GRANTED TO REGULATED AND/OR WIDELY-HELD NON-CIV FUNDS

1. What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

We believe that a private equity fund should be treated as widely held for purposes of determining eligibility under the LOB Rule if the fund and its related fund entities have, in the aggregate, 20 or more different direct investors, with no single investor representing more than 10% of the aggregate investor commitments to the fund and its related fund entities. Related fund entities should be taken into account, including parallel funds and feeder funds.

2. What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (i.e. “regulatory requirements relating to concentration of investments, restricting a CIV’s ability to acquire a controlling interest in a company, prohibiting or restricting certain types of investments, and limiting the use of leverage by the CIV”) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

We believe that U.S.-based private equity sponsors and their funds that are regulated by the U.S. Securities and Exchange Commission under the U.S. federal securities laws, including the U.S. Securities Act of 1933, the U.S. Securities Exchange Act of 1934, the U.S. Investment Company Act of 1940 and the U.S. Investment Advisers Act of 1940, and European-based private equity sponsors and their funds that are regulated pursuant to the European Union Alternative Investment Fund Managers Directive are currently subject to robust regulatory regimes. Given the comprehensive and substantial regulatory regimes governing private equity sponsors and their funds, and the particular focus on investor protections, we believe that private equity sponsors and their funds that are subject to either of the U.S. or European regulatory regimes described above should be treated in parity with CIVs for purposes of the LOB Rule.

3. Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. How would this treaty-shopping concern be addressed?

This question appears to presume that non-CIV funds are primarily established to enable investors to gain access to treaty benefits. We believe this presumption is unfounded. The typical private equity fund has an international investor base, with investors from all over the world, many of which would be entitled to the same or better treaty benefits as the fund or would benefit from relief under domestic laws of the countries in which portfolio companies are located (e.g., foreign government investors and pension funds). The typical private equity fund holds a
number of investments across a range of industries and geographies. The governing documents of many private equity funds contain provisions requiring such funds to satisfy certain diversification requirements in respect of their portfolio investments. In addition, investors do not exercise control over the selection of the particular investments that a private equity fund will invest into, or the jurisdictions in which the investments are located. For these reasons, private equity funds are unlikely to be used as a mechanism to obtain treaty benefits for its investors in respect of a portfolio investment in any particular country.

4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

Private equity funds are organized most frequently as fiscally-transparent limited partnerships in order to achieve tax neutrality and the flow-through of the characteristics of the underlying income realized by the fund. Under a tax transparent structure, each investor generally would be subject to tax under the rules of the investor’s jurisdiction of residence on its proportionate share of the fund’s income, even if no distribution is made by the fund to such investor. Proceeds received by a fund or a subsidiary holding company in connection with a disposition of an investment generally are required to be distributed promptly to investors. Private equity fund sponsors are incentivized to ensure that such distributions of investment proceeds are made promptly to investors because retention of uninvested capital would reduce investment returns. Accordingly, these structures do not provide the opportunity for taxable investors to defer tax.

5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception from the LOB rule that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly-listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

In the event that the OECD determines not to support the inclusion of private equity funds as “qualified persons”, the PEGCC would support the treatment of private equity funds and their subsidiary holding companies that are “widely held” or that are “subject to substantial regulation” as CIVs (and, therefore, as “qualified persons”) for purposes of the LOB Rule. Please see our responses to questions 1 and 2, above, for a description of the criteria for determining whether a private equity fund is widely held or subject to substantial regulation. We disagree with the assertion that this exception would be any more generous than the exception already provided for publicly-listed companies because a publicly-listed company could have a privately held class of shares representing nearly 50% of the company’s voting power and value and still satisfy the exception in the LOB Rule for a company whose principal class of shares is regularly traded on a recognized stock exchange. In any event, regardless of the rules that apply to publicly-listed companies, private equity funds are most analogous to CIVs, and, as we and many other commentators have demonstrated, share many of the same characteristics as CIVs. Therefore, we urge the OECD working group to adopt an approach that treats private equity funds and their subsidiary holding companies in parity with CIVs.
6. One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

Private equity funds typically do not hold interests directly in portfolio companies. Instead, a fund will organize one or more subsidiary investment entities to acquire and hold these interests. These subsidiary investment entities may be formed for a number of different commercial purposes, including providing liability insulation for the fund, facilitating financing arrangements in connection with an underlying investment and satisfying local legal requirements. Subsidiary investment entities are not used to facilitate tax avoidance, and granting such entities treaty benefits affords investors in a private equity fund tax neutrality in respect of capital invested through the fund in comparison to a direct investment in a portfolio company.

NON-CIV FUNDS SET UP AS TRANSPARENT ENTITIES

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

As recognized by the OECD in paragraph 14 of the Consultation Document, non-CIV funds are often unable to identify the tax residence of all of their investors. As a practical matter, investors in private equity funds often hold their interests in the fund through tiered entities, including other funds. Identifying the beneficial owners of interests in a typical private equity fund by looking through tiered entities is a time consuming and daunting process and substantially more burdensome than what is currently required by other applicable regimes, including FATCA rules. Accordingly, the PEGCC supports treating private equity funds that meet the “widely held” or “subject to regulatory oversight” standards as “qualified persons”.

8. The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?
Private equity funds typically have a broad base of investors that includes pension funds, tax-exempt entities, sovereign wealth funds, insurance companies, university endowments, foundations, family offices and other investment funds. Many of these investors are exempt from taxation in their own right (e.g., by virtue of a domestic law exemption for pension plans or other tax-exempt investors or as a result of sovereign immunity applicable to foreign governments and their controlled entities).

**SUGGESTION THAT THE LOB INCLUDE A DERIVATIVE BENEFIT RULE APPLICABLE TO CERTAIN NON-CIV FUNDS**

**-QUESTIONS RELATED TO CERTAIN ASPECTS OF THE PROPOSAL**

9. Unlike CIVs, which are defined in paragraph 6.8 of the 2010 Report on CIVs, the term “non-CIV” has no established definition. What would be the main types of investment vehicles to which the proposal could apply?

As more fully discussed in our January 2015 comments, private equity funds share many of the same characteristics as other collective investment vehicles, including a broad and diverse investor base and extensive regulatory oversight. Accordingly, the PEGCC supports treating private equity funds as CIVs, or alternatively, including private equity funds in a separate category of non-CIVs that are treated as “qualified persons”.

**-QUESTIONS RELATED TO THE IDENTIFICATION OF THE INVESTORS IN A NON-CIV**

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the interests in a typical collective investment fund that is widely distributed?

While the typical governing documents of a private equity fund impose restrictions on transfers, the ownership of interests in a fund typically will change over the term of a fund (typically ten years) as a result of privately negotiated transfers of interests.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimately own interests in the fund (for example under anti-money laundering, FATCA or common reporting standard rules)?

For FATCA purposes, a private equity fund sponsor will typically collect an IRS Form W-9 from each investor that is a U.S. person and an applicable IRS Form W-8 from each investor that is a non-U.S. person. IRS Form W-9 provides information regarding the U.S. investor providing such form, such as the investor’s name, address, U.S. tax classification and U.S. taxpayer identification number. The particular type of IRS Form W-8 provided by a non-U.S. investor generally is determined based upon the U.S. tax classification of the non-U.S. investor providing the form. An IRS Form W-8 provides similar identifying information regarding a non-U.S. investor, including the investor’s FATCA status. A non-U.S. investor that is the beneficial owner of an interest in the fund for U.S. federal income tax purposes and that provides the fund with an IRS Form W-8BEN or W-8BEN-E may also include a claim to the benefits of a tax treaty between the United States and the jurisdiction of residence of such investor in respect of
certain types of income received from the fund. A non-U.S. investor that is treated as a flow-through entity from a U.S. federal income tax perspective, or that holds fund interests as a nominee for another person, generally is required to provide the fund with an IRS Form W-8IMY and to attach applicable IRS withholding forms in respect of the owners of such flow-through entity (or, in the case of a nominee, the applicable IRS withholding form in respect of the person for which such interests are held). However, depending on the U.S. FATCA classification of the non-U.S. investor providing IRS Form W-8IMY and the underlying fund income in respect of which such withholding form is being provided, limited or no U.S. withholding information may be provided in respect of the ultimate owners of such non-U.S. investor. FATCA is designed to identify direct and indirect ownership of accounts by U.S. persons in certain foreign financial institutions and is not designed to identify the treaty entitlements of the beneficial owners of any particular entity. As a result, the information collected under FATCA is limited in scope and generally will not provide a fund with sufficient information to identify the indirect beneficial owners in a private equity fund or their particular treaty entitlements.

The common reporting standard rules ("CRS") require a private equity fund to collect information regarding the controlling persons in relation to certain investors, such as investors that are non-financial entities and certain trusts. Given the limited scope of these disclosure requirements, many investors are not required under CRS to provide controlling person disclosures to the private equity fund in which they are investing. Further, the definition of a controlling person for purposes of CRS does not necessarily identify the ultimate beneficial owner because of its focus on management and control and not on beneficial ownership.

16. Is this information currently sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what types of documents and procedures could be used by a non-CIV to demonstrate to tax authorities and/or payors that the residence and treaty entitlement of its ultimate beneficial owners are such that the non-CIV qualifies for treaty benefits under that suggested derivative benefits rule? What barriers would exist to the communication of these documents or the implementation of these procedures? In particular, does intermediate ownership present obstacles to obtaining information about ultimate beneficial ownership and, if yes, how might these obstacles be addressed?

As more fully discussed in our June 2015 comments, identifying and monitoring the ultimate beneficial owners of interests in a private equity fund on an ongoing basis is administratively complex and commercially impractical. Private equity funds typically have limited ability to identify the tax status of indirect investors and have limited or no control over changes of the tax status of indirect investors, with whom the fund is not in privity of contract. As illustrated in Example 2 in the Appendix to our June 2015 comments, a private equity fund typically would have no control over transfers of interests in a fund of funds that is a direct investor in the private equity fund. Therefore, even if the private equity fund obtained sufficient information from the transferor in the fund of funds, and both the transferor and transferee were, in fact, equivalent beneficiaries, the private equity fund may be unable to obtain information regarding the transferee in order to establish that the transferee is an equivalent beneficiary under the derivative benefits rule.
17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities (which is not the case of typical CIVs), how would the proposal overcome the difficulties derived from such complex investment structures with multiple layers and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

Please see our responses to questions 3 and 6 above.

18. The proposal would grant treaty benefits if a certain high percentage of a non-CIV is beneficially owned by investors entitled to similar or better benefits. Even a percentage as high as 80% would leave substantial room for treaty-shopping as a 20% participation in a very large fund could represent a significant investment. How could this concern be addressed?

As discussed above, private equity funds are not used by investors as vehicles for treaty shopping. For the reasons explained above, we believe that it is appropriate to treat private equity funds that meet the “widely held” or “subject to regulatory oversight” standards as “qualified persons”. In the event that a private equity fund does not satisfy the criteria for being treated as widely held or subject to a substantial regulatory regime, we believe a more narrowly tailored approach could be adopted for granting treaty benefits to such funds in appropriate circumstances. Specifically, we propose that private equity funds and their subsidiary holding companies should be eligible under the LOB Rule for the benefits of a particular treaty to the extent that a fund is able to certify that at least 50% of its direct and indirect investors (based on aggregate investor commitments) are comprised of pension funds and other tax-exempt investors, governmental entities or instrumentalities and their controlled subsidiaries, and investors that would otherwise be eligible for the benefits of the applicable treaty in their own right, and/or other private equity funds (such as funds of funds) that satisfy the requisite ownership threshold in their own right (collectively “Eligible Investors”).

We believe that, for purposes of certifying as to whether a fund satisfies a minimum 50% Eligible Investor ownership threshold to qualify for treaty benefits, the fund and its sponsor should be entitled to rely on representations that the fund’s investors provide regarding their status as Eligible Investors for purposes of an applicable treaty. Under this approach, a private equity fund or its sponsors would obtain representations from each of its investors as to the jurisdictions for which such investor is an Eligible Investor. The fund or the sponsor, on behalf of the fund, would then provide a self-certification as to the fund’s eligibility for treaty benefits under a particular treaty each time benefits are sought by the fund based upon the representations from its investors. While private equity funds would be required to track the reported Eligible Investor status of its direct investors across the jurisdictions in which the fund is investing, such funds would not be required to act as a withholding agent or otherwise be required independently to verify the status of its indirect beneficial owners through multiple tiers of ownership. We believe that such a reporting protocol will help to alleviate concerns of treaty shopping, while balancing the administrative and practical realities that many private equity funds encounter, as
described in greater detail in our earlier comments. We would be happy to provide assistance in developing a suitable form of self-certification that could be provided by private equity funds under this approach.

**SUGGESTION OF A “GLOBAL STREAMED FUND” REGIME**

24. Although the above proposal for a “Global Streamed Fund” regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on: (i) whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis; (ii) whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are; (iii) whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties; and (iv) what should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?

The PEGCC does not believe that the GSF regime is an appropriate or feasible alternative for providing private equity funds and their investors with access to treaty benefits and ensuring tax neutrality in respect of invested capital. This proposal raises significant practical and administrative concerns for private equity funds consistent with the practical and administrative issues that arise in applying the LOB Rule to these funds. As we have commented previously, private equity funds may have hundreds of investors and these investors often invest through tiered entities, including other funds. Private equity funds often make investments in numerous different jurisdictions, each with different treaty rules. It will often be impractical, if not impossible, for a fund to determine the treaty entitlements of each of its investors in respect of all sources of income of the fund and effectively act as a withholding agent in respect of such income. Even if this level of inquiry were feasible as a practical matter, it would be a time consuming and daunting process, particularly for funds with large numbers of investors, and would impose substantial additional compliance costs upon funds and their investors. We do not see how such a proposal alleviates in any way the practical, administrative and policy considerations raised by us and other commentators with regard to the granting of treaty benefits to non-CIV funds.
OECD – PUBLIC CONSULTATION ON BEPS - TREATY ENTITLEMENT OF NON-CIV FUNDS

Following the publication of the Public Discussion draft “Treaty Entitlement of Non-CIV Funds” on 24 March 2016, we provide below some observations on the issues under discussion. Our observations are based on both the indications contained in the Public Discussion Draft and Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) and on the operating and administrative approach adopted with respect to the application of Treaties to non-CIV funds.

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Suggestion that treaty benefits be granted to regulated and/or widely held funds

1./2. We believe that non-CIV fund that:

(a) are managed on a discretionary basis by a professional investment manager that acts independently from investors in the fund; and

(b) are widely-held as they represent the interests of a wide investor base;

should be allowed to obtain treaty benefits as the above-features should by themselves provide sufficient protection against treaty abuse.

We also believe that the existence of a regulatory framework should not represent a necessary precondition for an exception to the LOB rule, as regulatory frameworks may vary from one jurisdiction to another (e.g. in terms of different scope and focus), it may be difficult to set a standard requirement in this respect, taxpayers may also face difficulties in obtaining from regulators certificates or evidences attesting the applicable regulatory framework (e.g. in certain jurisdictions, the regulator may be prepared to issue a formal certification attesting the existence of regulatory supervision on the taxpayer whilst in other jurisdictions this is not the case) and it may be difficult to impose to regulators a standard template to release certificates that should be useful for the purpose of applying tax treaties.
Setting a threshold above which a non-CIV fund may be defined as “widely-held” (for example, stating that treaty benefits do not apply if the fund is owned by a single beneficiary, either directly or indirectly, for more than a stated threshold) as the sole requirement for an exception to the LOB rule would provide, on one side, additional safeguard to taxing rights and, on the other side, would simplify evaluation of specific cases.

The criteria to calculate the threshold should consider the case in which the non-CIV fund is participated by one or more investors that, in turn, represent a plurality of investors. In this respect, further criteria should be set to ensure that the “widely held” requirement is deemed to be satisfied even in the case in which a non-CIV is participated by an investor in excess of the stated threshold but said investor is another non-CIV that in turn is “widely held” in the light of the stated threshold.

With respect to the definition of the threshold for determining that a fund is “widely held” for the purpose of the proposal, we believe that 10% may be deemed to be a reasonable compromise.

It should be clarified in the guidelines whether the stated threshold is to be calculated having regard to the number of investors, the value of their investment in the fund and the basis for its calculation (in this case, it should be clarified whether the condition is to be satisfied at any point in time or reference is to be to the time of entering the fund or at the time of realization of the income for which the treaty benefits are claimed, etc).

3. We believe that no treaty-shopping concern may arise in granting treaty benefits to non-CIVs to the extent that the exception to the LOB is grounded on the existence of:

(a) management on a discretionary basis carried out by an investment manager that acts independently from the investors in the fund (so that the investors cannot exercise control over it); and

(b) the “widely-held” requirement.

In the presence of a non-CIV fund that satisfies said requirements, it may be deemed that the fund represents a genuine investment instrument rather than a vehicle that may be used by investors to obtain treaty benefits otherwise not due.

4. We believe that no mandatory distribution requirement for a non-CIV fund to be eligible to the exceptions to the LOB rule should be foreseen. Indeed, such a requirement could represent an issue in the light of one of the main elements underlying the concept of discretionary asset management on a collective basis and, in particular, the autonomy that the investment manager should have in deciding whether an investment or divestment should be made and whether available financial
resources in the hands of the fund should be reinvested or instead distributed as proceeds to the investors. Therefore, exceptions to the LOB rule should be recognized to non-CIV funds having regard only to their features and investors base (in the light of criteria suggested above) and irrespective of any mandatory distribution requirement. From this perspective, deferral of taxes should not be of concern as tax considerations should be subordinate to the genuineness of the non-CIV fund.

5. The exceptions to the LOB rule should be recognized to non-CIV funds having regard only to their features and investors base (in the light of criteria suggested above). Limiting the exceptions to the LOB rule by inserting specific features into a specific non-CIV exception could create compliance burden on taxpayers and ultimately jeopardise the results of the exception itself.

6. We believe that in the presence of a chain of intermediaries, reference should be made in the first place to the tax status of the intermediary receiving the income from the State of source. In circumstances in which a look-through approach is adopted, exception to the LOB rule should apply based on the circumstance that the chain of intermediaries includes, at any level of the chain, a non-CIV that satisfies the above criteria.

Documentation to obtain treaty benefits

One of the issues raised in the Public Discussion Draft concerns the practical difficulties of gathering the relevant information on investors in non-CIVs. This is a key practical issue, and one of current interest, that should be clearly dealt with by interpretation guidance (as part of the Commentary to article 1 of OECD MTC) and by issuing international best practices generally accepted and shared by tax administrations.

As suggested under point 14 of the Public Discussion Draft, in some instances (for example, in the case of multi-tiered non-CIV funds involving various jurisdictions and different layers of Funds and investors) it is not possible to provide all “relevant tax information” in terms of tax residence, jurisdiction of incorporation, liability to taxation, payment of taxes, requests from tax administrations addressed to individual investors in the non-CIV fund. In the lack of clear guidance, difficulties also arise for non-CIV funds in obtaining the direct application of treaty benefits while dealing with other entities that have the obligation to act as withholding tax agents (for instance, in connection with the payment of dividends or on interest).

In order to remove such practical and interpretation doubts and difficulties, it would be desirable to have a standard OECD documentation template concerning the information to be provided (similar, for example, to that prepared in respect of dividends, interest and royalties), generally accepted and shared by tax
administrations, including with regard to cross-border tax audits besides standard criteria to be adopted by taxpayer in evaluating the specific case.

If the non-CIV fund has the features describe above, the request for tax information should stop at the first layer of the ownership chain.

In the case of non–CIV funds that are established in a State that allows the exchange of information between the tax authorities, we believe that the tax authorities should validly accept self-certifications issued by non–CIV funds or by the relevant investment manager, with no need to gather additional documentation on the tax residence, and in general the tax status, of the underlying investors. In practice, if compliant with the tax authorities’ accepted standards to be defined, such self-certifications should be a valid basis (that the tax authorities of the State of source may assess based on the exchange of information) to obtain recognition of treaty benefits.

The same should apply in the case of non-CIV funds that, albeit established in a State that does not allow the exchange of information, are managed by an investment manager that is resident in a State that allows the exchange of information.

This would serve a double purpose: reducing taxpayers’ compliance costs and eliminating interpretation doubts on the matter.

Moreover, the preparation of standard documentation accepted and shared by tax administrations would not only improve communication between the tax authorities and taxpayers but encourage prior communication with the tax authorities and, more generally, the implementation of Cooperative Tax Compliance models.

Finally, it should also be considered that a “full and unconditional” disclosure of the information on the investors’ individual tax position may even be contrary to treaty rules, to the extent that said rules prohibit the supply of sensitive (say, commercial or professional) information, and to the provisions of local domestic legislation.

Best regards

Pirola Pennuto Zei e Associati
Dear Sir/ Madam,

**BEPS Discussion Draft: Treaty Entitlement of Non-CIV Funds**

PricewaterhouseCoopers International Limited on behalf of its network of member firms (PwC) welcomes the opportunity to comment on the OECD's Public Discussion Draft on the Treaty Entitlement of Non-CIV Funds. Paragraph 9 of the Report on Action 6 OECD/G20 BEPS Project reaffirmed that collective investment vehicles (CIVs) should be entitled to treaty benefits. We commend the Working Party for its ongoing efforts to ensure that new treaty provisions emerging from the BEPS initiative also adequately address the treaty entitlement of non-CIV funds.

Our main comments broadly follow the organization of the Discussion Draft. For ease of reference, in Appendix 1 we also address each of the 28 questions raised, on a line by line basis.

Savings and investment are key contributors to a healthy global economy, and collective investment plays a vital role in efficiently employing investment capital. Paragraph 14 of the Report on Action 6 recognizes this economic importance of non-CIVs, and "the need to ensure that treaty benefits be granted where appropriate". An investor in any fund, including a non-CIV, should not suffer a tax penalty merely for pooling its resources with other investors, and this “neutrality” should certainly be the case in any situation where the reason for investment is risk diversification or to secure economies of scale. This is particularly so for institutional investors such as pension funds and insurers, which generally are subject to regulation in their state of residence and whose investment spectrum may, as a result and because of a relative lack of in-house expertise in these more specialised areas, look to include alternative asset classes or private equity investments via committing capital to non-CIVs, often in significant individual tranches.

Alternative approaches are needed to achieve the goal of providing appropriate treaty access for the broad range of non-CIVs, without giving rise to treaty abuse. Many non-CIVs have a strongly diversified range of investments within a specific class, thus achieving the basic goal sought by investors of risk-spreading. Many also have a diverse investor base, some with a considerable turnover, and others with a very stable and often numerically smaller base. Funds often make use of a tiered structure, with a master fund owned by feeder funds, in order to accommodate the needs of different categories of investors. No one single approach can address this diversity of funds and structures.

The invitation to comment only raises specific questions relating to Action 6 measures and their effect on non-CIVs. We are concerned that this might mean that wider issues concerning the tax treaty entitlement of non-CIV fund vehicles and their commercially-driven corporate structures are less likely to be addressed. We believe that more funds (non-CIVs) which do not, as matters stand, meet the CIV criteria (i.e. being sufficiently widely held, subject to investor-protection regulation, and owning a diverse portfolios of securities) might appropriately be treated comparably to CIVs, and thus benefit directly from the treatment available to CIVs. This should be achieved through a widening of the “CIV” definition. Notably, the questions now raised, concerning how "widely held" and "regulated" ought to
be construed, should be set in the context of refining, clarifying and broadening the definition of “CIV”, rather than in the narrower ambit of framing and interpreting an OECD Model LOB provision.

Similarly, further encouragement to governments, to work on implementing into more treaties the recommendations already in the Model Commentary regarding adding specific and detailed treaty text to deal explicitly with CIVs, should apply equally to what is currently regarded as the non-CIV space.

To make any proposed solutions effective, the Working Party should weight carefully the benefits and burdens of adding any additional compliance or reporting obligations for non-CIV funds, especially regarding their ultimate investors. Privacy concerns also need to be heeded. A number of our comments below are focused on these aspects.

In relation to the concerns in the Discussion Draft on the issue of deferral, we believe that income deferral is not inherently tax abusive. Were all deferral to be considered abusive, states would not need to structure CFC/PFIC type regimes to distinguish between "good" deferral and unacceptable deferral. Deferral should only be seen as an abuse in a limited field of situations, and these are often best addressed by the domestic regime of the investor state.

Limitation of benefits approach

Regulated or widely held

As noted above, more funds (non-CIVs) which do not currently meet the CIV criteria, ought, through a widening of the CIV definition, to be treated comparably to CIVs, and thus benefit directly from the treaty entitlement available to CIVs. Increasingly, Alternative Investment Funds are being set up in, or moved to, regulated environment jurisdictions and, clearly pass the “regulated” test, and so if the “widely held” and “portfolio” tests were made a bit clearer and easier, they could then pass all three tests.

An exception to the LOB rule for non-CIV funds that are both widely held and regulated would take into account the typical non-tax commercial purposes of these funds. As the Discussion Draft suggests, treaty shopping concerns in these types of situation are minimized by their very nature.

A widely held definition could require:

- a minimum number of ultimate beneficial owners (thereby allowing for tiered structures where there may be a master fund owned by two or more feeder vehicles which are owned by the ultimate investors), and
- no single ultimate beneficial owner may own more than a specified percentage (such as the 20% standard used in the Australian Investment Manager Regime regime), and
- no five or fewer ultimate beneficial owners may own over 50% of the fund.

In meeting the widely held test, a single institutional investor which is widely held may be considered to be equivalent to an investor base of a number of beneficial owners, on the basis that it represents a wide number of members/beneficiaries. A “managed account” real estate fund owned 98% by a widely held pension fund and 2% by the fund manager is common in the industry and may be as deserving of “neutrality” as a fund that has a very wide direct investor base.

Another type of fund that presents a low risk of treaty abuse is a fund with a diversified portfolio of investments, possibly combined with a requirement that the fund or its professional manager be regulated. If there is no regulator, whose basic principles for risk spreading may be applied, potential criteria for a diversified portfolio might relate to the following, applicable after a reasonable start-up period (although the specific thresholds should be subject to further discussion):
• average of 20 or more investments during the life of the fund, and
• no greater than 20% ownership of any single investment, and
• no single investment to exceed 20% of the NAV of the fund at the time the investment is made.

The “widely held” and “diversified portfolio” criteria may also be of particular relevance in considering the Commentary on the practical application of the PPT.

**Transparency/ documentation**

Given the growing move towards transparency, including measures such as CRS and FATCA which generally require the identification of beneficial owners, it would seem practical for ultimate investors to be required to provide the necessary documentation gathered to show the ultimate beneficial owner is resident in a treaty jurisdiction. We note, in that regard, that the US already has long-established documentation procedures that have proved effective, including forms for claiming entitlement to treaty benefits (Forms W-8 BEN (for individuals), W-8 BEN-E (for entities), W-8 EXP (for tax exempt entities), and W-8 IMY (for intermediaries). Withholding agents (whether it be the fund or a payer to the fund) can generally rely on the certifications in the forms.

If, as a general rule, a non-CIV fund has the option to claim treaty benefits on behalf of, or as a proxy for, its investors, that may allay the concerns attributable to the nature of some funds. This is common practice in the US for fiscally transparent entities. To the extent the fund is unable to determine the treaty status of any investor, it could apply the relevant source country domestic statutory rate on the proportionate income/ gains allocable to such investor. That investor, if eligible for treaty benefits under its treaty with the source country, could then file a refund claim under the source country’s refund procedures. In our experience, withholding agents tend to take a conservative approach to determining the proper rate of withholding since they may otherwise be liable for the investor’s tax, plus penalties and interest, with the possibility of limited recourse to the investor who may have already disposed of the investment at the time a tax authority alleges there has been an under withholding.

Although it may seem a burdensome and potentially impractical solution to adopt strict transparency requirements for purposes of the PPT, in situations where the information is not collected by the relevant fund and/or the fund entities do not want to share this information with paying entities, the full rate of withholding tax could be applied (as if all investors were in non-treaty jurisdictions).

**Limited derivative benefits test**

A derivative benefits test could prove to be an effective and important alternative for non-CIV funds that are not fiscally transparent or have a diversified investor base to qualify for treaty benefits while allaying fears about treaty shopping.

However, the proposal that each investor would have to be entitled to the same or better treaty rate as the non-CIV fund under their respective treaties with each source country seems unworkable where either the investors or the investments are geographically diverse. Consider, for example, a fund with investors from countries A, B, C, D, & E with investments sourced in countries X, Y, and Z – the fund would need to meet the equivalent rate test under 15 bilateral treaties. Treaties often have varying rates applicable to a given category of income and, in the case of dividends, different rates for companies and individuals and below we recommend a workable alternative that achieves the combined goals of preventing treaty abuse and a test of practical application.

The shortcomings of an equivalent rate test could be addressed if a derivative benefits test looked to whether a high enough percentage of investors were resident in states that have a comprehensive
income tax convention with the source country that provided a substantial reduction in the rate of tax applicable to the relevant category of income (the ‘equivalent treaty test’).

Allowing a fund with diverse investors to have a minority of investors that are not treaty qualified should not constitute treaty abuse where the fund was not established for the purpose of giving minority investors access to treaty benefits. We note in that regard that most of the tests in the currently proposed version of the LOB article in the OECD Model use a 50% threshold for ownership and, where applicable a 50% base erosion test. That is, the Model sets a standard that if benefits of the treaty are being enjoyed by a majority of ‘good’ owners (and, where applicable, recipients of base eroding payments), the entity is, per se, viewed as not treaty shopping and therefore entitled to the benefits of the treaty. We see no reason non-CIVs should be held to a higher standard than the classical corporate taxpayer that is subject to a 50% test. We note that the figure used in the ‘simplified’ version of derivative benefits clause in the BEPS final recommendations was 75% but that test is oriented to global corporate groups where ownership commonly is 80% or greater.

One option open to the Working Group, consistent with ensuring non-CIVs are entitled to treaty benefits where appropriate, is to provide two derivative benefits tests: one using an equivalent rate test and, perhaps a lower good ownership threshold because of the inherently limited scope of the test (mainly usable for funds whose ownership is concentrated in a single jurisdiction) and one using the above “equivalent treaty” test, making derivative benefits workable for funds with a diverse investor base, with a higher ownership threshold.

Under any of the above tests (broadly applicable in PPT situations as well), investors such as pension funds, governments or governmental funds, and charitable organizations should be treated as good investors as they would commonly be exempt from taxation had they directly received the investment income and cannot be treaty shopping by choosing to invest through a collective investment vehicle.

To the extent the Working Party opts to include an equivalent rate test, we note the 2016 US Model Treaty treats individual shareholders as companies for purposes of a similar rate comparison test (with respect to dividends). We note also that the 2016 US Model Treaty addresses the cliff-edge effect of an equivalent rate test – the tested entity can in appropriate circumstances apply the higher rate applicable in the treaty between the source country and the residence country of the owner of the tested company.

In order to take account of the fact that many funds use a master/feeder structure, it would be important to apply any derivative benefits test at the level of the ultimate beneficial owner.

**Blended rate approach**

A third approach might allow a fund to opt to use a blended rate of withholding (which might also apply where countries adopt a PPT approach). The concept would require the fund to determine the rate of withholding that would apply to each of its investors had they invested directly in the asset producing the income and weight these rates according to investors’ percentage interests in the relevant income. The fund could then provide a worksheet to the withholding agent detailing its calculations available to the source country tax authority on request.

This approach could be implemented in a way consistent with the operation of current domestic law provisions in some countries (e.g. a system similar to this already applies in the US), which require recipient entities to submit documentation to paying entities in the source country that confirms who the ultimate investors are, where they are tax resident and what treaty benefits they qualify for. Based on this information, a blended withholding tax rate could be calculated and applied to payments made to the recipient entity. This reduces the unnecessary burden on the source state to determine what
withholding tax rate to apply (i.e. full rate or reduced rate as per double-taxation agreements), which could be complicated where there are a number of investors in multiple jurisdictions, and instead places the obligation on the holding companies themselves, to distribute the income to the relevant investors at the applicable rates.

The fund would be responsible for disaggregating the blended withholding tax paid and ensuring the ultimate tax cost was borne by the appropriate investors. Although there is a risk that investors in treaty jurisdictions might face undue tax at the expense of investors in non-treaty jurisdictions (e.g. if the fund did not disaggregate and applied the blended rate across all investors), we expect that the market will put the appropriate measures in place to ensure that the distributions are taxed correctly when paid to the investors. This will also be of relevance where the distribution received from the source state is not distributed, but is used to service/pay down debt at the investment company level.

Current international initiatives on information exchange (i.e. FATCA and CRS) include minimum reporting requirements that already require the information in respect of the identity of the ultimate investors in most investment schemes. As such, the information needed to calculate the blended rate should be readily available for most non-CIVs, even in complex tiered fund of funds structures. However, we note that it will be important for the funds to have reporting status under CRS for there to be a clear obligation to collect the data on investors and report it.

Sufficiently substantial connection

Given the diverse structures of non-CIVs, we have not attempted to address at this stage the suggestion made by some commentators and questioned by the OECD that a ‘sufficiently substantial connection’ test would be appropriate to entitle a non-CIV to treaty benefits.

Principal purposes test approach

We note the focus in the Discussion Draft on examples specifically relating to non-CIV funds that could be added to the Commentary on the PPT rule. We believe that it will also be necessary to define the terms “widely-held”, and possibly “equivalent treaty test”, in the Commentary, to give clarity to the scope of application of these examples.

The examples certainly need to reflect the key characteristic of very many non-CIV funds: the need, for good and legitimate commercial reasons, to have almost always one, and often more, corporate layers between the fund vehicle and the target investment asset. Without specific reference to detailed fact patterns, these commercial reasons may include:

• limitation of risk (e.g. to provide investors with contractual protection against personal liability for claims against the fund or individual assets),
• permitting effective co-investment by other parties into individual investments, thus further spreading risk and opening up investment opportunities,
• banking security, often requiring more than one level of holding company, to provide a pledge to be given over a single company’s shares,
• administrative simplicity (e.g. a single legal shareholder owning investments, to provide a simpler acquisition and ongoing governance structure compared to multiple investors), and
• facilitating regulatory compliance and investor reporting, allowing a single entity management board to provide oversight of the entire portfolio.

The examples should also recognise and accept that this corporate structure will also tend be set up so as seek overall tax “neutrality” for investors, i.e., being driven by a “good” tax-related motive, rather than being a tax treaty shopping strategy.
On deciding the location of the corporate platform, the fund manager considers a range of factors, with particular emphasis on:

- stability and certainty in the political, regulatory, domestic tax and legal system as investments may be held for a number of years,
- clarity that the applicable corporate law permits timely and efficient cash extraction (e.g., in respect of a disposal of part of an investment),
- availability of suitable local premises, staff, administrative support and other professional advisors at a reasonable cost.

Bearing in mind these considerations, the examples in Appendices 2-5 distinguish elements of the application of the PPT in different scenarios.

**Example A** (see Appendix 2) describes a typical alternative investment structure, having a corporate “platform” beneath the fund vehicle. It confirms that, in part because the fund is “widely held”, the application of the PPT should not be triggered when considering treaty access by the corporate platform entities.

**Example B** (see Appendix 3) describes another common type of alternative investment fund, having a corporate “platform” similar to that of Example A. Although not as widely held, the fund manager has sufficient knowledge of the fund investor base to be able to confirm that the majority of the capital invested in the fund comes from ultimate beneficial owners that can satisfy an “equivalent treaty” test. Consistent with our comments above concerning a limited derivative benefits test in the context of an LOB rule, this test would look at whether investors were resident in states that have a comprehensive income tax convention with the source country (i.e. where the fund’s investment asset is located and for which treaty access is in point) which provided for a substantial reduction in the rate of tax applicable to the relevant category of income. Again it confirms that the application of the PPT should not be triggered because a minority of investors are not treaty qualified, so long as there was no purpose when the fund was established of giving minority investors access to treaty benefits.

**Example C** (see Appendix 4) considers the situation of an alternative investment fund that fits the fact patterns of either Example A or Example B but where the fund manager mainly conducts the management of the fund’s assets from a state other than that where the corporate “platform” is resident. On the basis that this geographical separation occurs for good commercial reasons, it is confirmed that this factor should not affect the application of the PPT.

**Example D** (see Appendix 5) describes an alternative investment fund that has a notably diversified portfolio of investments. It confirms that this is a strong indicator of the absence of treaty abuse, and thus that the application of the PPT should not be triggered.

**Distribution and deferral**

The requirement for non-tax exempt investors to include their proportionate share of non-CIV fund income on a current basis would disadvantage funds established with the purpose of long term appreciation. A prime example is a fund that invests in an infra-structure project that may last for decades, with any earnings from the project reinvested to fund the on-going working capital needs.

We noted earlier that the concept of income deferral is not inherently tax abusive.

Many funds pool investor monies for long-term investment and growth and, therefore, reinvest the proceeds from any interim returns during the life of the fund. The re-investment decision for such funds is strictly for non-tax reasons while in other funds with no commercial reason not to distribute any return on investment to investors, it is usual to see the funds’ terms demand current distribution.
Deferral should only be considered an abuse in limited situations. Improper deferral opportunities typically arise because of the specific application and interpretation of domestic tax anti-deferral regimes (or lack thereof). To that extent, while it is important to minimize the possibility for improper deferral opportunities, this is better addressed through appropriate domestic anti-deferral regimes since the tax being deferred is the tax in the investor’s home jurisdiction. All investors in a fund should not be penalized because some investors are resident in jurisdictions that have not enacted adequate anti-deferral rules.

If there remains a concern over abusive deferral, a rolling multi-year mandatory distribution requirement as opposed to an annual distribution requirement would more realistically take into account the need to meet fund expenses as they arise as well as allowing for longer term, or at least medium term, objectives. A typical holding period for funds whose objective is capital appreciation is three to five years, although some funds hold for much longer periods, as in the case of infrastructure projects.

A current distribution requirement applicable to ordinary income rather than capital gains would be targeted to any potential abuse without depriving many funds that seek long term appreciation of treaty entitlement. However, requiring funds with a goal of long-term appreciation to currently distribute ordinary income would distort the funds’ investment objectives. As noted, we believe abusive deferral is inherently self-policing since a fund that does not have long-term growth as an objective will be marketable only if the fund currently distributes its income and that requirement is often embedded in fund documents.

Other matters

- **Global Streamed Fund Regime** - We note that adopting a type of regime as described in the Discussion Paper would necessitate changes in the domestic tax laws of all participating jurisdictions. This may take several years. A Global Streamed Fund regime would however appear to be one viable solution to addressing treaty entitlement of certain non-CIV funds, were such changes to be implemented. The Working Group should therefore hold further extended consultations with interested parties on the Global Streamed Fund regime proposal, including with member states. A particular ‘test-bed’ area of focus might be funds which make long term investments in illiquid assets such as infrastructure.

- **Privacy Concerns** - Privacy of investor information is a critical concern. For example, a withholding agent may actually be in competition for clients with the fund manager, so the fund manager does not want to reveal its customer list to competitors. Investors may be concerned about disclosure of their investments for competitive reasons or personal security reasons. We believe it is of paramount importance to establish procedures that limit disclosure of investor names and investment details. The US, for example, allows intermediaries to act as “Qualified Intermediaries” that either report pooled information or assume the withholding responsibility with the investor information directly reported to the relevant tax authority and Withholding Foreign Partnerships and Withholding Foreign Trusts that agree to assume the withholding responsibility and provide the investor information directly to the relevant tax authority. The exchange of investor information between the tax authorities is limited to exchanges pursuant to an income tax treaty or exchange of information agreement whereby the requesting tax authority undertakes to protect the privacy of the information requested.

The period between publication of the Discussion Draft and the deadline for submissions has been relatively short so our response does not explore ideas in as much detail as our specialists might like.
However, we would be very keen to discuss with you any questions you have on the points we raise above or on other specific matters raised by respondents to the Discussion Draft.

Yours faithfully,

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Concerns related to the LOB provision

Regulated and/or widely-held non-CIV funds.

1. What would be the threshold for determining that a fund is "widely held" for the purpose of such a proposal?

Response:
   a. The definition should be aimed at whether there is a concentration of investment traceable to one or more investors. The use of an approach as detailed as the UK’s “genuine diversity of ownership” test, may be considered as we set out in our June 2015 comment letter on Action 6. A definition based on the Australian test that requires that no investor hold a fixed percentage of the value of the fund (e.g., 20%) and no five or fewer investors own, in the aggregate, 50% of the fund might also be a workable approach.
   b. It is important that the test take into account many funds involve tiered structures (which can be fund created, such as, the master/feeder structure, or investor created). Thus, the test should look to the ultimate beneficial owners.
   c. It is important to also recognize that widely held funds will take time to build up to the targeted size. These funds often start with a select group putting up “seed money” and it may take more than a year to reach full operational size. Hence, there needs to be a start-up rule allowing a fund that is being offered to the public a couple of years of deemed widely held status.
   d. Consideration should also be given to an alternative test for widely held for funds whose investments are geographically diverse (combined with a regulatory requirement).

2. What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal?

   [A potential reference is made to regulatory requirements described in paragraph 16 of the 2010 IV report] What about disclosure requirements relating to distribution of interests?

Response:
   a. Because each jurisdiction’s regulatory regimes may vary, it is important to keep the regulation requirement generic. We suggest it should encompass general regulatory oversight. Examples could be included for greater certainty such as:
      • EU - Transparency Directive, the Prospectus Directive, the Alternative Investment Fund Managers Directive and the Consolidated Admissions and Reporting Directive”,
   b. In many jurisdictions, it will be the asset manager, rather than the fund, that is subject to regulation. Thus, the regulatory requirement should be viewed as met whether it is the fund or the fund manager that is subject to the regulation. For example, the text of the EU’s AIFMD confirms this, stating that “the objective of this Directive, namely to ensure a high level of investor protection by laying down a common framework for the authorisation and supervision of AIF [Fund managers] ...”.
   c. It would be appropriate to require that the fund and fund manager be in compliance with all applicable anti-money laundering/know your customer laws and regulations and all other governmental rules or regulations relating to the knowledge of and/or disclosure of holders of interests in the fund.
3. Since the proposed exception would apply regardless of who invests in the funds, it would seem relatively easy for a fund to be used primarily to invest in a country on behalf of a large number of investors who would not otherwise be entitled to the same or better treaty benefits with respect to income derived from that country. In that respect, how would this treaty-shopping concern be addressed?

Response: It would be highly unusual for a fund that is going to be widely held to be formed with a principal purpose of obtaining treaty benefits. Further, the hypothetical situation of a widely held and regulated fund isolating its investments to a single country would be out of the norm.

4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution?

Response:
   a. That will vary depending on whether the investor's country of residence has enacted anti-deferral regimes, such as the US PFIC and CFC regimes.
   b. See our detailed discussion of deferral and distribution requirements.

Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception (to the LOB rule) and if yes would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

Response: See our detailed discussion. In short, the fund’s distribution policy should adequately address any concern about improper deferral. If the fund’s investment objectives are long term growth, then interim returns on investment would be reinvested and to require mandatory distributions would distort the investment return. Not currently taxing re-invested returns for a fund with long term appreciation as its goal is not abusive; rather, currently taxing the return would be disruptive to the non-tax business reasons for the funds existence. Funds that do not have long term appreciation as an investment goal will almost always be required by their investors to distribute income on a current basis. For those funds, any concern about deferral is self-policing. Any concern about interim entities should be addressed under anti-deferral regimes, not by denying treaty benefits to the fund. This would be particularly troublesome when the intermediary is created by the investor rather than the fund. All investors would be penalized because a single investor used a tiered structure for its investment, regardless of whether the tiering was tax motivated or needed to meet a non-tax requirement of the investor’s home country.

5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception that would apply to any widely-held fund, even if it is regulated, especially since that exception would seem more generous than the exception already provided for publicly listed companies. What features could be incorporated into a specific non-CIV exception in order to make it more acceptable to these States?

Response: The comparison to publicly traded corporations is misplaced. The proper comparison is to CIVs and widely-held non-CIVs have essentially the same positive features as CIVs and should be treated comparably. They are vehicles for collective investment which the OECD has recognised as being important to a healthy global economy. See our detailed response for our further discussion on widely held funds.
6. One argument that was put forward for excepting non-CIV funds from the LOB rule is that it would avoid/reduce cascading tax when the investment is made through various intermediaries. In practice, what is the intermediate entity-level tax, if any, which is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

Response: Intermediate vehicles are most commonly transparent and therefore tax neutral. In some cases, the intermediary may be non-transparent so as to centralise tax burden and reporting on the intermediary entity rather than exposing hundreds or thousands of investors to local tax payments and reporting in every jurisdiction where the fund invests. These intermediary vehicles are often used to accommodate specific restraints that may apply to, for instance, a governmental fund whose local laws restrict direct ownership of voting power in certain target investments. Intermediary vehicles, if they are not transparent, would typically be established in a jurisdiction that imposes little or no income tax. Hence, leveraging – from either related or unrelated parties – would have no tax impact.

Non-CIV funds set up as transparent entities

7. Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State entitled to the benefits of the treaties concluded by that State?

Response: As detailed in our comment letter, there are practical ways to deal with the proper identification of the ultimate beneficial owners, particularly with the growing acceptance of transparency and the advent of measures such as CRS and FATCA, as well as the TRACE project.

Limited Derivative Benefits Test

8. What is the meaning of "institutional investors" in the context of alternative funds? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition, how can it be concluded that institutional investors "are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Funds". Why are institutional investors less likely to engage in treaty-shopping, as it has been suggested?

Response:

a. The term institutional investors is generic and its scope can vary.

b. Generally, it is a reference to non-business entities such as pension funds, national government funds, state and local funds, college endowments and other charitable organizations. Common to most of these entities is that they are typically exempt from taxation. It should not be considered abusive to extend treaty benefits to an entity that is not taxable by its country of residence.

c. To deny similar benefits to other entities, like insurers that carry out equivalent functions, to the extent that they are competing directly with such institutional investors and are not designed for abusive purposes, would seem to unfairly discriminate against their investors (including pensioners and the like).
9. Unlike CIVs, the term "non-CIV" has no established definition. What would be the main types of investment vehicles to which the proposal [the derivative benefits test] could apply?

   Response: Common to all non-CIVs is the fact that they are vehicles for collective investment. The types of investment may vary considerably from equity to alternative sources of investment (such as debt instruments). However, common to these entities is that their investments are managed, directly or indirectly, by an investment manager.

10. The derivative benefits test proposal refers to the possible inclusion of "specific anti-abuse rules". What would these rules be?

   Response: We note that anti-abuse rules discussed elsewhere in the BEPS project, including anti-deferral rules, conduit rules, and anti-hybrid rules, as well as the PPT for countries that choose to include a PPT in addition to an LOB, would continue to apply to a non-CIV qualifying under the derivative benefits test. In addition, the derivative benefits test has criteria for its applicability, would could be viewed as anti-abuse rules.

11. What would constitute a "bona fide investment objective"?

   Response: The fact that a fund’s investment manager is in the trade or business of providing investment services, is subject to general regulatory oversight, and has an investment management agreement with the fund should entitle any directly or indirectly managed investment vehicle to meet this bona fide investment objective.

12. How would it be determined that a fund is "marketed to a diverse investor base"?

   Response: The burden of establishing this would be on the fund. Typically, there should be documentation available to support this assertion (e.g. PPM’s, AIFMD filings).

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the investors in a typical widely distributed CIV?

   Response: This will vary from fund-to-fund. Some will have a stable set of investors that turn over infrequently; others, may have frequent turnover of investors.

14. How would the [derivative benefits test] proposal address the concern that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and therefore would not know the treaty residence and tax status of these beneficial owners?

   Response: In today’s regulatory environment, most non-CIVs will have systems in place to track the ultimate beneficial owners as this will commonly be required under CRS, FATCA, and the like. In fact, the US withholding procedures require documentation of beneficial owners, including a requirement that any intermediary entity collect beneficial owner information from its owners and pass that information on down the chain of ownership. If the non-CIV cannot determine its beneficial owners, it will not be able to qualify under the derivative benefits test. This is further discussed in our comment letter.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimate own interests in the fund (e.g., under FATCA)?

   Response: See response to Q.14.
16. Is this information sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what type of documents and procedures could be used in that regard? What barriers would exist to the communication of these documents?

Response: See response to Q.14. See our comment letter for a discussion of privacy concerns and how to address those concerns.

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities, how would the [derivative benefits test] proposal overcome the difficulties derived from such complex investment structures and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

Response: See above responses and the discussion in our comment letter.

18. Even a percentage as high as 80% of investors entitled to similar or better benefits would leave substantial room for treaty shopping as a 20% participation in a fund could represent a significant investment. How could this concern be addressed?

Response: We refer to the OECD Model LOB which generally accepts that if over 50% of the owners of a business entity are qualified and, where applicable, a base erosion test is met, the entity should per se be viewed as not abusing the treaty and fully eligible for treaty benefits, even if a substantial minority of investors may be resident in countries that do not have a relevant tax treaty. We do not believe non-CIVs, which the OECD has repeatedly acknowledged as serving an important role in a healthy global economy should be held to higher standard than business entities. This is discussed in further detail in our comment letter.

19. Wouldn’t the 50% threshold proposed for the base erosion test be too generous?

Response: See our response to Q.18. Fundamentally, a 50% base erosion test is uniformly accepted for business entities (even in the case of the derivative benefits test of the OECD Model LOB, although, as detailed in our comment letter, we do not believe the Model’s derivative benefits test is the right comparison).

Prevention of Deferral

20. According to the proposal, acceptable ultimate beneficial owners would include persons who would "include their proportionate share of the fund's income on a current basis." How would a State of source be able to determine when this requirement is met? Also what is considered an acceptable anti-deferral regime (e.g., the US's PFIC regime)?

Response: The documentation requirements discussed in the context of Qs 14 – 16 addresses this question. Regarding what should be an acceptable anti-deferral regime, the decision should be at the discretion of the country of residence of the ultimate beneficial owner since it is that country's tax that is being deferred.

21. Who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis (in regards to structures with various intermediate owners)?
Response: The derivative benefits test will need to define who is considered the ultimate beneficial owner. We believe the right answer to that is the first person up the chain of ownership that could have claimed equivalent benefits, however that is defined. (See the discussion in our comment letter of how an equivalent benefit should be defined.) If that person could have obtained equivalent benefits by investing directly, rather than through the non-CIV, there could be no treaty abuse. It is that person who should be tested under any anti-deferral regime. Our comment letter discusses the topic of deferral and the fact that deferral is not *per se* abusive.

The new derivative benefits test in the US Model

22. In addition to this potential derivative benefits rule that would apply specifically to non-CIV funds, the OECD is now looking at possible changes to the general derivative benefits provision that appeared in the Report on Action 6 in light of the new derivative benefits provisions include in the 2016 US Model Treaty. Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the "seven or fewer" condition of the US Model's derivative benefits provision. What other aspects of the 2016 US Model’s derivative benefits provisions would be problematic for non-CIV funds?

Response: The US Model derivative benefits test should not be the standard for the non-CIV derivative benefits test. As discussed in our comment letter, the US Model test is mainly of significance for global corporate groups and the role of the non-CIV derivative benefits has a different aim entirely. The only relevant comparison is that both tests are based on the premise that if the owner(s) of the tested company could have received equivalent benefits directly, there is no treaty abuse. Further, the US Model derivative benefits test is excessively complex and most of the bases for this complexity are not relevant to non-CIVs. We would note, in particular, the proscription on intermediate owners severely limits the use of the test and we have discerned no meaningful policy justification for the intermediate owner limitation.

Non-CIV having Substantial Connection with its State of Residence

23. Are there practicable ways to design a "substantial connection"

Response: Given the diverse structures of non-CIVs, we have not attempted to address this proposal. We defer to those who have made the suggestion, while observing that Paragraph 19 of the Discussion Draft already identifies many relevant factors that could be used.

"Global Streamed Fund" Regime

24. Since this "Global Streamed Fund" regime is very recent, the OECD invites comments on its different features, particularly: (i) whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis; (ii) difficulties for non-CIV funds that cannot, for various reasons, determine who their investors; (iii) whether suggestion that on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties; and, (iv) what would be the consequences if it is subsequently discovered that the fund did not meet the requirements for qualifying as a Global Streamed Fund?

Response: As discussed in our comment letter, we believe this proposal is worthy of further consideration as an alternative. We stress, however, that it will take considerable time for implementation of the proposal as formulated and it is not a substitute for the alternatives presently under consideration.
Concerns related to the PPT rule

25. The OECD invites new examples to add to the Commentary on PPT which do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

Response: We set out in our comment letter and in Appendices 2-5, some new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds.

Concerns related to “anti-conduit rules”

26. The OECD asks for examples if there are significant risks that the PPT rule could apply to some legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19.

Response: We are not providing any new examples in this area. However, we believe that the examples we have provided adequately address any concerns of treaty abuse and do not require any special anti-conduit rules beyond the anti-conduit rules a country choses to include as a general matter.

Concerns related to the “special tax regimes” proposal

27. The Report 6 recommendations will be redrafted in the light of the 2016 US Model Treaty that adjusted the definition of “special tax regimes”. Is there any specific “statute, regulation or administrative practice” related to non-CIV funds that could constitute a special tax regime and that would give rise to concerns?

Response: Any redrafting of the Report 6 recommendations based on the 2016 US Model Treaty that adjusted the definition of “special tax regimes” would require detailed consideration for all taxpayers. At this stage we do not see any justification for any different standard relating to non-CIVs.

Other suggestions

28. This question provides the opportunity to suggest any modifications to the Report on Action 6 not otherwise dealt with in Questions 1-27, to address issues related to the treaty entitlement of non-CIV funds.

Response:

a. We have provided specific comments in our letter which provide some alternative suggestions to those put forward. In particular, we draw attention to the comments on greater qualification of funds as CIVs; funds which are widely held or which have a diversified portfolio; alternative types of derivative benefits tests and the idea of allowing use of a blended rate of withholding.

b. Further encouragement to governments to work on implementing into more treaties the recommendations already in the Model Commentary regarding CIVs, is not only felt to be important in the context of giving explicit treaty recognition to CIVs, but should extend to looking further into what is currently regarded as the non-CIV space. For example, the text of the new “post-BEPS” Germany-Australia double tax treaty, signed in November 2015 but not yet ratified, takes a small step in this direction by not only including as treaty text the paragraph 6.8 definition of a CIV, but extending it to core-style real estate funds.
Principle Purposes Test

Example A – Widely held fund

A fund manager is looking to establish a new fund. The fund manager markets the prospective fund to a wide range of potential sophisticated (i.e. non-retail), investors, including pension funds, sovereign wealth funds, high net worth individuals, and other institutional investors, with the aim of having the fund widely held once fully invested. The mandate of the fund is to invest in a portfolio of existing, unrelated businesses, or a portfolio of real estate or infrastructure assets either to secure a stream of income or to benefit from appreciation in the capital value of these assets, and to manage these businesses or assets. A range of investors resident in different jurisdictions commit capital to the fund.

The platform for the fund comprises a “master” holding company established in State A, which is likely in due course to own sub-holding companies also established in State A. While some of the entities may only have a relatively low level of activity (consistent with the functions they perform) each will have a genuine economic reason for existing.

Funds will often include one or more corporates as part of the overall platform for a number of commercial reasons, and it is important to take these into account in the analysis. Without specific reference to detailed fact patterns, these reasons may include:

• limitation of risk (e.g. to provide investors with contractual protection against claims on the fund or individual assets),
• permitting effective co-investment by other parties into individual investments, thus further spreading risk and opening up investment opportunities,
• banking security often requiring more than one level of holding company to provide a pledge to be given over a single company’s shares,
• administrative simplicity (e.g. a single legal shareholder owning investments to provide a simpler acquisition and ongoing governance structure compared to multiple investors), and
• facilitating regulatory compliance and investor reporting, allowing a single entity management board to provide oversight of the entire portfolio.

On deciding the location of the corporate platform, the fund manager considers a range of factors, with particular emphasis on:

• stability and certainty in the political, regulatory, domestic tax and legal system as investments may be held for a number of years,
• clarity that the applicable corporate law permits timely and efficient cash extraction (e.g., in respect of a disposal of part of an investment),
• availability of suitable local premises, staff, administrative support and other professional advisors at a reasonable cost.

It is possible that when the fund is initially launched, a smaller number of investors provide the initial seed capital for the fund which is then used to attract a wider investor base. The widely held investor base may take some time to establish (e.g. 2-3 years), but the fact that this wider base is not yet achieved, provided it can be demonstrated that the seed capital has been used to attract a wider investor base and the fund has been actively marketed during this time, should not preclude treaty benefits from applying in this initial period.
In making the decision to locate the platform in State A, the fund manager considers the existence of income tax conventions between State A and the states in which the target investments were likely to be resident, but this alone should not be sufficient to trigger the application of the PPT. At the time State A is chosen as the location for the platform (so it can be included in the marketing material), the identities of individual investors amongst the widely held investor base, and their tax attributes are still unknown. Unless the investments or the platform are part of an arrangement, or relate to another transaction, undertaken for a principal purpose of allowing investors indirectly to obtain the benefits of State A’s tax conventions (such investors not satisfying an equivalent treaty test), it would not be reasonable to deny the benefit of these conventions to the platform companies.
A fund manager is looking to establish a new fund. The fund manager markets the fund to a known investor base where the tax residence status of each investor is known and can be confirmed by the investors on an as-needed basis. The fund vehicle sets up a basic platform for the fund that is constituted by one or more holding companies established in State A.

The platform for the fund and the commercial reasons for structure and location are as in Example A.

In making the decision to locate the holding companies in State A, the fund manager considers the existence of benefits under the tax conventions between State A and the states in which the target investments were likely to be resident.

The majority of the investors in the fund are investors where it can be demonstrated that the investors would have qualified to use the appropriate treaty themselves, or would be equivalent beneficiaries under the terms of another state’s tax treaty with the state where the investment is made.

The fund manager is able to use existing (or soon to be available) mechanisms such as CRS, FATCA or TRACE to confirm on a periodic basis that the significant investor base are entitled to equivalent benefits.

However, there will often not be 100% of investors in good treaty locations. Having a minority of investors that do not qualify for treaty benefits should not preclude the qualifying investors from obtaining their benefits if the intent of tax treaties in providing benefits (or preventing blockage) to encourage cross-border investment is to be maintained.

The main purpose of setting up the fund vehicle was commercially driven.
**Principle Purposes Test**  
*Example C – Widely marketed fund – Investment management service location separated from holding company location*

A fund manager is looking to establish a new fund. The fund manager markets the prospective fund to a wide range of potential sophisticated (i.e. non-retail), investors, including high net worth individuals, pension funds, sovereign wealth funds, and other institutional investors. The mandate of the fund is to invest in a portfolio of existing, unrelated businesses and to manage them. A range of investors resident in different jurisdictions commit capital to the fund.

The platform for the fund and the commercial reasons for structure and location are as in Example A.

In this example, the management vehicle for the fund vehicle is based in State B where the activities constituting day to day management of the assets within the fund take place.

The location of the management vehicle is chosen primarily so that the fund manager group is best able to draw on a wider pool of investment and management advisors as well as have access to better ancillary services in State B than is available in State A. However, State A offers a more commercial location in which to set up the fund platform.

In making the decision to locate the holding companies in State A, the fund manager did consider the existence of income tax conventions between State A and the states in which the target investments were likely to be resident but this alone should not be sufficient to trigger the application of the PPT for the same reasons as in Example A.

The location of the management vehicle for the fund should not have any impact on the analysis as this has been located outside State A for commercial reasons as State B gives the fund access to a much wider range of investment and other specialists than is available in State A.
Principle Purposes Test
Example D – Non-CIV funds with a diversified portfolio

A fund manager is looking to establish a new fund. The fund manager markets the prospective fund to a wide range of potential sophisticated (i.e. non-retail), investors, including high net worth individuals, pension funds, sovereign wealth funds, and other institutional investors. The mandate of the fund is to invest in a portfolio of existing, unrelated businesses and to manage them. A range of investors resident in different jurisdictions commit capital to the fund.

The platform for the fund and the commercial reasons for structure and location are as in Example A.

In this example, the non-CIV fund may not over time achieve a diverse investor base.

Notwithstanding the lack of a diverse investor base, a fund structure that could still present a low risk of treaty abuse is a fund with a diversified portfolio of investments, especially where this is combined with a requirement that the fund or its professional manager is regulated in order to gain access to appropriate treaties.

We have outlined below potential criteria that may be identified for a diversified portfolio:

- average of 20 or more investments during the life of the fund, and
- no greater than 20% ownership of any single investment, and
- no single investment to exceed 20% of the NAV of the fund at the time the investment is made.

Unless the investments or the platform are part of an arrangement, or relate to another transaction, undertaken for a principal purpose of allowing investors indirectly to obtain the benefits of State A’s tax conventions (such investors not being equivalent beneficiaries under the terms of another state’s tax treaty with the state where the investment is made), it would not be reasonable to deny the benefit of these conventions to the fund’s platform companies.
Comments on BEPS Action 6 - Treaty entitlement of non-CIV funds

Thank you for the opportunity to provide comments on the Public Discussion Draft entitled “Treaty entitlement of non-CIV funds” which was released for comment on 24 March 2016 (“Discussion Draft”).

This submission is made by the Queensland Investment Corporation (QIC) and the New Zealand Superannuation (NZ Super Fund).

For the purposes of this submission, institutional investors are considered to be widely held entities on the basis they are either pension funds, sovereign wealth funds (SWFs) or widely held unlisted funds. This submission does not consider the treatment of investments made by an individual or controlled entities of an individual.

Executive Summary

1. The Commentary to the OECD Model Tax Convention (Model DTA) should include comments confirming that the Principal Purpose Test (PPT) is a “purpose” test and not a “substance” test. It should also confirm that the PPT is an alternative test to the Limitation on Benefits (LOB).

2. If the principal purpose for establishing a non-CIV investment entity in its state of residence is a non-tax purpose, a non-CIV investment entity should be entitled to treaty benefits, even if the availability of treaty benefits was one of several considerations in determining the location to establish the non-CIV investment entity.

3. If a non-CIV investment entity fails the PPT, investors in the non-CIV investment entity, whether transparent or not, should be entitled to treaty benefits that would have been available if the investor had invested directly. If member states did not support this derivative benefits approach for all investors, at a minimum we submit that treaty benefits should be granted to pension funds and sovereign funds.

4. The Model DTA standard clauses in the dividends and interest articles should provide for the ability of contracting states to confer upon government investors (as appropriately
defined) an exemption from source country taxation for income derived by government investors.

In support of these submissions, we have provided below detailed submissions on the provision of treaty benefits for non-CIVs and a look-through approach to the ultimate institutional investors of the non-CIV investment entities. Furthermore, we have provided direct answers to selected questions in the Discussion Draft which are relevant to QIC and New Zealand Super Fund. We have also included appendices covering:

- The doctrine of sovereign immunity (Appendix One)
- Examples of the intended operation of the PPT (Appendix Two)

2 Introduction

The proposed amendments to the Model DTA and Commentary in respect of the LOB and PPT rules seek to ensure that taxpayers do not avail themselves of treaty relief in circumstances where it would be inappropriate for them to do so.

Institutional investors, in particular pension funds and SWFs are an increasingly important source of global investment capital.

In recent years institutional investors have diversified their portfolios beyond bonds and equities by adding allocations to alternative investments such as private equity, real estate, infrastructure, agricultural and hedge funds.

SWF and pension fund investors seek global efficiency from a taxation perspective as they are generally exempt or concessionary taxed in their home market and thus taxes in intermediate jurisdictions represent a real cost of making the investment.

Therefore, amendments in respect of the LOB and PPT rules should take into account substantial differences between the nature of investments made by non-CIVs into infrastructure and real estate, as compared to a corporate investor utilising wholly-owned subsidiaries to inappropriately access treaty benefits.

3 Treaty Benefits for non-CIVs

The structure of the CIV industry described in the CIV Report\(^1\) focussed exclusively on portfolio equity and debt funds. In these funds the underlying investors have no direct rights over the assets in the fund and rely entirely upon the manager to make all decisions regarding the operation of the fund. This should be contrasted with another common type of investment

\(^1\) [http://www.oecd.org/tax/treaties/45359261.pdf](http://www.oecd.org/tax/treaties/45359261.pdf)
which is a consortium of institutional investors purchasing an infrastructure asset through a non-CIV created for the particular acquisition\(^2\).

### 3.1 Reasons for establishing a non-CIV investment entity

The breadth of geographies and asset classes in which institutional investors participate means that it is necessary to establish non-CIV investment entities in jurisdictions outside their country of residence for many of their investments.

Whilst it is difficult to generalise, it is common for institutional investors from the southern hemisphere to co-invest in non-CIVs with other investors resident in either Europe or North America. Taking into account the residence of the local manager, the asset and time zone differences, it would not make commercial sense to set up a non-CIV in Australia or New Zealand to invest into an asset located in Europe, especially where other co-investors are North American or European.

As SWFs and pension funds have mandates to invest prudently to ensure that they can meet future obligations, their investment decisions take into account many factors which affect their return on investment, including any tax burden. Institutional investors therefore consider a wide variety of issues when evaluating an investment and the investment structure. Given the investment of institutional investors across a wide portfolio of assets in various global markets, they are generally likely to employ regional offices and/or external managers to administer and manage their investments.

Institutional investors also invest as part of consortia to gain exposure to large, illiquid assets i.e. real estate and infrastructure investments.

Unlike multinational corporates which often operate in a single industry with branches in multiple countries, institutional investors are likely to use specialist external managers or regional offices to manage their investments (particularly when investing into highly specialised assets subject to local regulation such as infrastructure projects). Often the external managers and regional offices are resident in a jurisdiction other than where the institutional investor is resident.

The use of a regional office or manager in a third state is one of the most common structuring options used by institutional investors for their investments and may have a number of advantages over direct investment:

- Economies of scale through pooling of capital - investment exposure to larger assets;
- Geographical proximity to the intermediary jurisdiction, which may assist in exercising governance rights over the asset;

Better investment risk management through portfolio diversification; and
Access to specialist manager expertise.

In addition, we note that institutional investors are experienced in selecting and administering their investment portfolio, but are unlikely to be directly involved in the day-to-day operation of the assets they acquire as, they may lack the necessary expertise. In the case of some institutional investors, their constituent documents may prohibit direct investment in non-financial assets. Accordingly, for assets like infrastructure and real estate, minority stakes in CIVs may be the only permissible way to invest.

To overcome this, it is common practice for institutional investors to appoint a manager, who has experience in operating the assets which they have acquired. This has resulted in the rise in popularity of non-CIVs situated in the jurisdiction where the fund manager is based as opposed to investment vehicles situated in the State in which the asset is located.

3.2 Principal purpose test

Based on the comments at section 3.1, we support the suggestion that if the principal purpose for establishing a non-CIV investment entity in its State of residence is a non-tax purpose, a non-CIV investment entity should not be denied treaty benefits, even if the availability of treaty benefits was one of several considerations in determining the location of the non-CIV investment entity.

We also support the approach adopted by the OECD that the PPT should be undertaken objectively, having regard to all of the relevant facts and circumstances of the establishment of the non-CIV investment entity.

Any commentary supporting the Model DTA which deals with the PPT should make it clear that obtaining a benefit under a DTA does not prima facie mean that that outcome was one of the principal purposes of an arrangement or transaction. Furthermore, the commentary should emphasise that determining the purpose of establishing a non-CIV investment will require more than merely reviewing the tax effects of an arrangement.

Where, however, an arrangement can only reasonably be explained by a benefit that arises under the DTA, then the commentary should make it clear that the principal purpose of the arrangement would be to obtain the benefit.

If the non-CIV investment entity was formed for valid commercial purposes and the activities of that entity establish a substantial connection with the state of residence, these purposes and activities should be sufficient evidence that obtaining treaty benefits was not one of the principal purposes for using the non-CIV investment entity.

4 Treaty benefit if the institutional investor had invested directly

If a non-CIV investment entity fails the PPT, investors, regardless of whether the non-CIV investment entity is transparent or not, should be entitled to treaty benefits that would have been
available if the institutional investor had invested directly. If member states feel that extending this approach to all investors in a non-CIV imports an unworkable level of complexity between states, this could be applied solely in respect of institutional investors in the non-CIV.

4.1 **Operation of look-through approach**

Under this approach, an investor resident in Country A, who participates in the non-CIV investment entity (which is resident in Country B) will be eligible for treaty benefits in respect of items of income (including profits or gains) derived from the source country (Country C) through the entity established in Country B, to the extent that Country A treats the income as beneficially owned by the resident of Country A. Resident participants in the entity will be treated as having derived the income directly and may be entitled to treaty benefits. Treaty benefits in respect of such items of income (including profits or gains) will be granted where:

- The beneficiaries, members or participants of the non-CIV are considered residents of Country A under the relevant DTA; and

- Other conditions in the DTA are satisfied.

We are concerned that any denial of treaty benefits would result in high domestic withholding rates applying to distributions from the state of source, notwithstanding the ultimate owner of the income (i.e. the institutional investor) would have been entitled to a lower rate of tax had it invested directly. As has been mentioned earlier in this paper, institutional investors will often make investments via a non-CIV for a number of non-tax reasons and therefore should not be penalised for investing via a non-CIV where direct investment would have resulted in a more favourable tax outcome, but was not possible for non-tax commercial reasons.

We acknowledge the “look-through” approach involves practical complexities which include:

- The mechanics of three jurisdictions being required to treat the non-CIV as fiscally transparent (i.e. the countries of source, residence of the intermediate entity and the country of residence of the institutional investor); and

- Confirmation of the residency of the institutional investor (and its entitlement to treaty benefits) by the source state and withholding agents in that state.

However, given the nature of the institutional investors who invest via a non-CIV, we submit that there are simple practical solutions to these complexities.

In respect of the first complexity, this can be addressed if the Model DTA and its accompanying commentary required jurisdictions to treat entities which meet a standard definition of a non-CIV investment entity as fiscally transparent. This would lead to an outcome which is consistent with established OECD practice relating to investment via transparent intermediate entities, and would enable the institutional investor to look-through the intermediate entity and apply the Country A-Country C DTA.
In relation to the second complexity, a streamlined approach can be developed based upon a common standard to enable institutional investors to confirm to the state of source their residency status and their entitlement to tax treaty benefits in their jurisdiction of residence. Given that most institutional investors such as pension funds and sovereign investors are tied to a specific jurisdiction either through enabling legislation or their state-sanctioned role, they will be able to confirm their residence and entitlement to tax treaty benefits under existing integrity measures. Self-certifications, such as those used under the OECD’s Standard for the Automatic Exchange of Financial Account Information in Tax Matters (commonly referred to as the “CRS”) or the U.S. qualified intermediary (“QI”) regime, could be preferable ways to confirm the residence of the institutional investor within currently accepted frameworks.

Source countries would need to provide clear guidance as to whether and in what circumstances that documentation would need to be provided to a withholding agent and/or the source country government.

Our experience is the “know your client”, FATCA and anti-money laundering requirements being imposed by most jurisdictions mean that tracing the ultimate ownership of non-CIV investment entities can be undertaken within existing frameworks.

If governments provide clear rules regarding the documentation that non-CIV investment entities must collect regarding treaty entitlement, non-CIV investment entities could collect that documentation as part of their on-boarding of investor processes.

Where a non-CIV investment entity cannot identify its investors, or cannot identify all of its investors, we suggest unidentifiable investors be treated as not eligible for treaty benefits.

5

**Direct responses to selected questions in the Discussion Draft**

**Question One**

“What would be the threshold for determining that a fund is “widely-held for the purpose of such a proposal?”

A definition of a “widely-held” fund, should include (but not necessarily be limited to), non-CIV funds that are predominantly owned directly or indirectly by SWFs, recognised pension funds, public reserve fund or a combination of these funds.

We note that institutional investors such as SWFs, pension funds and life insurance companies are not established to generate wealth or profit for a small group of people as in the case of a corporate. Rather, they are established as a matter of government policy to meet intergenerational or contractual commitments relating to ongoing retirement or other welfare obligations of its citizens.
Question Four

Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution? Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception and if yes, would intermediate entities be required to distribute earnings up the chain of ownership on a mandatory basis? If not, how would concerns about deferral of tax be addressed?

Granting tax benefits at the level of the non-CIV investment entity should not raise concerns about deferral, when the non-CIV investment entity is owned predominantly by institutional investors or tax-exempt entities. Tax deferral is generally not an issue in the context of investments by institutional investors in non-CIV investment entities because these investors are often tax exempt in their local jurisdictions. We also note that many jurisdictions’ domestic law includes anti-deferral legislation that would apply to taxable investors in non-CIV investment entities. In any event institutional investors would as a rule prefer to repatriate cash when it is available so as to ensure that these funds can be deployed more efficiently into other investment activities.

Whilst the Base Erosion and Profit Shifting (BEPS) project remains relevant to institutional investors, it should be acknowledged that institutional investors themselves are predominantly government owned or regulated and they operate in a different manner to multinational corporates. As a result, the BEPS issues arising in the context of multinational corporates such as excessive debt financing, shifting of profits to low-tax jurisdictions and participation in aggressive transfer pricing arrangements are not pertinent to institutional investors.

Question 8

The rationale that was given for the above proposal refers to the fact that “investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”. What is the meaning of “institutional investors” in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of “institutional investors”, how can it be concluded that institutional investors “are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund”? Also, is it suggested that “institutional investors” are less likely to engage in treaty-shopping and, if yes, why?

We suggest that the definition of “institutional investors” should be wide enough to cover recognised SWFs, recognised pension funds and life insurance companies.

In this context, SWFs should be defined to cover globally recognised government sponsored investment entities which invest funds for the benefit of the citizens of that government rather than any individual. Consistent with established approaches to sovereign immunity in most
OECD countries\(^3\), the definition of a SWF should **exclude** government owned trading entities and state-owned enterprises which undertake commercial activities. A government owned trading entity which is not generally entitled to sovereign immunity includes companies such as government owned broadcasters, electricity suppliers and telecommunications companies. By way of distinction, SWFs are special purpose investment funds set up by a state or political subdivision of the state for macroeconomic reasons such as meeting a future government liability (e.g. pensions) or as a mechanism for intergenerational funds transfer. Investment entities generally do not take majority interests in underlying businesses and do not participate in the day-to-day management or operation of the investee entity.

We refer to the OECD’s Public Discussion Draft – “Treaty Residence of Pension Funds” concerning the definition of “recognised pension fund” and submit that the meaning of pension fund should take into consideration the public submissions made in that work stream. We also refer to the previous Discussion draft on the application of tax treaties to SWFs in 2010\(^4\) and submit that the consultation on that definition should be taken into consideration when defining an institutional investor.

With respect to the PPT, we support the suggestion that under the PPT, if the principal purpose for establishing a non-CIV investment entity in its state of residence is a non-tax commercial purpose, a non-CIV investment entity should not be denied treaty benefits, even if the availability of treaty benefits was one of several considerations in determining the location to establish the non-CIV investment entity.

### Question 25

**Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.**

With respect to Question 25 of the Discussion Draft, we have participated in public consultation with HM Treasury, UK and support the Examples drafted by their office as attached in Appendix Two. We have also provided a third example to demonstrate an example of when the PPT is failed how the look through approach should be applied. This will provide institutional investors with a degree of certainty as to the operation of the PPT.

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\(^3\) Please refer to Appendix 1 for a discussion of approaches to sovereign immunity.

\(^4\) Discussion Draft on the Application of Tax Treaties to State-Owned Entities, Including Sovereign Wealth Funds, November 2009 to 31 January 2010.
Foreign Governments should also be encouraged to rule or give a view on the application of the PPT in relation to specific investment structures established or to be established by widely held institutional investors.

If you have any questions in relation to our submission, we would be pleased to discuss further.

Yours faithfully

John Payne
Head of Tax
New Zealand Superannuation Fund

Vince Quagliata
Head of Tax
QIC
Appendix 1 – Sovereign immunity

A number of States provide concessionary tax treatment for pension and SWFs and their subsidiaries, usually in the form of an exemption from withholding taxes.

These jurisdictions include Australia, Canada, USA, UK, France and Korea.\(^5\)

Suggested parameters of activities qualifying for sovereign immunity:

Given the broad range of investments made by government-supported non-CIVs, it is important to ensure that any exemption is based upon a concept of eligible sovereign investment activities that accommodate passive investment by foreign governments, without providing an effective tax subsidy to foreign state-owned commercial enterprises. The doctrine of sovereign immunity should apply to income which is beneficially owned by a state, or political subdivision or a local authority (including a government investment fund) in the performance of governmental functions where the following criteria are satisfied:

- the person making the investment (and therefore deriving the income) is a foreign government or an agency of a foreign government performing governmental functions;
- the moneys being invested are and will remain government moneys and will not be distributed to any entities other than the government itself; and
- the income is being derived from a non-commercial activity.

An activity undertaken by a foreign state or governmental agency should generally be accepted as the performance of governmental functions provided that the agencies are wholly owned and controlled by the government and do not engage in ordinary commercial activities. This approach is consistent with the decision of the British House of Lords in the case *I Congreso del Partido* [1981] 2 All ER 1064 which held that activities of a trading, commercial or other private law character were not governmental functions.

*Extension of doctrine of sovereign immunity through the Model DTA*

The availability of sovereign immunity varies between jurisdictions. Whilst common law countries such as Australia, the United States and the United Kingdom do recognize and apply a doctrine of sovereign immunity, several European nations such as Poland, Norway and Switzerland do not recognize this principle in their domestic laws and therefore do not grant a specific exemption for foreign government investors.\(^6\)

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5 For a more detailed listing see www.law.wisc.edu/m/s2njd/swfs_taxation_arial_717_08.doc - accessed 29 December 2014

The doctrine of sovereign immunity has been specifically negotiated into existing bilateral DTAs based upon the mutual agreement of the contracting states\(^7\). Whilst the incorporation of sovereign immunity into individual tax treaties has so far depended on negotiations between individual states, the certainty that this offers makes this option the preferred route to providing certainty for foreign government investors.

The inclusion of sovereign immunity in the Model DTA dividends and interest articles allows the contracting states to confer an exemption from source country taxation provided key criteria outlined above have been met.

One of the key challenges states face when dealing with claims for sovereign immunity is the commercial and political intentions of foreign governments. As such, there may be a reluctance to grant a foreign government preferential tax treatment for income derived from an investment in an industry or business which is regarded as being a commercial venture by a state owned enterprise of the other contracting state. However, these concerns can be mitigated by limiting the availability of the sovereign immunity exemption to portfolio investments made by specifically named sovereign investors (or investors which are a government of the other contracting state) which do not involve the investor taking a role in the operation or control of the target investment, consistent with the indicia of sovereign immunity set out above. Guidance could be provided in the Commentary to clarify when the granting of sovereign immunity would be appropriate, setting clear parameters on when the exemption could be provided.

As the example of the Australia-New Zealand DTA shows\(^8\), states can be free to negotiate the entities upon which sovereign immunity is conferred. In this DTA, the Australian Government has specifically confirmed in the accompanying Explanatory Memorandum it prepares which government investment entities in Australia and New Zealand the contracting states agreed to cover in Articles 10(4) and 11(3)(a). We have extracted the relevant sections of the Dividend Article (Article 10(4)) and Explanatory Memorandum to the Australia-New Zealand DTA below.

**Dividends article – Article 10(4)**

Notwithstanding the provisions of paragraph 2, dividends shall not be taxed in the Contracting State of which the company paying the dividends is a resident if the beneficial owner of the dividends holds directly no more than 10 per cent of the voting power of the company paying the dividends, and the beneficial owner is a Contracting State, or political subdivision or a local authority thereof (including a government investment fund).

**Commentary from Explanatory Memorandum**

Dividends which are beneficially owned by a State, or political subdivision or a local authority (including a government investment fund) will be exempt from tax in the source country if they

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\(^7\) See, for example, the Australia-New Zealand Double Tax Agreement

\(^8\) See Articles 10(4) and 11(3)(a).
hold no more than 10 per cent of the voting power in the company paying the dividends. This exemption complements that provided in respect of interest derived by States, their political subdivisions and local authorities (including government investment funds) under Article 11 (Interest). In the course of negotiations, the two delegations agreed:

'. . .that dividends and interest will be regarded as being derived by a Contracting State, political subdivision, local authority or government investment fund where the investment is made by the Government and the funds are and remain government monies.

The delegations also agreed that this would include dividends and interest paid to, in the case of New Zealand, the New Zealand Superannuation Fund, the Government Superannuation Fund, and in the case of Australia, the Future Fund, the Building Australia Fund, the Education Fund and the Health and Hospital Fund, as well as any similar fund the purpose of which is to pre-fund future government liabilities.'

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* Explanatory Memorandum, to the *International Tax Agreements Amendment Bill (No. 2) 2009*, Paragraph 2.184.
Appendix 2 – PPT Examples

Example 1: Sovereign Wealth Fund (or Pension Fund)

RCo, a company resident in State R, is a wholly owned subsidiary of a recognised sovereign wealth fund (the “Fund”) resident in State T. RCo operates exclusively to earn income for the benefit of the Fund and acquires and manages a diversified portfolio of private market investments located in countries neighbouring State R to generate a long-term investment return. The commercial reasons for RCo being established in State R include:

- greater connectivity with local markets and underlying investments in nearby jurisdictions;
- access to appropriately qualified personnel;
- its economic, legal and political stability; and
- time zone efficiencies.

RCo’s personnel have responsibilities including the following:

- reviewing investment recommendations from the Fund’s global investment teams;
- making investment decisions and monitoring investments’ performance;
- undertaking treasury functions;
- acting as board directors for entities in which RCo has invested;
- maintaining RCo’s books and records;
- ensuring compliance with regional regulatory requirements; and
- providing services to any additional subsidiaries in State R.

One of RCo’s portfolios of investment holds a 40% interest in a company resident in State S, in respect of which it receives annual dividends. Under the convention between State R and State S, the withholding tax rate on dividends is reduced from 30% to 5%. Under the convention between State T and State S, the withholding tax rate on dividends is reduced to 10%.

In deciding to invest in the company resident in State S, RCo took into account the benefits of State R-State S tax convention on dividends, but this is not sufficient to trigger application of paragraph 7. The purpose of tax treaties includes providing benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, having regard to all facts, it is not reasonable to deny RCo the benefit of the State R-State S tax treaty.
**Example 2: Infrastructure Investment**

RCo also holds an investment in an infrastructure project in State S, where it co-invests with other institutional investors (e.g., an infrastructure fund comprised predominantly of institutional investors). These investors provide both equity and debt finance to the project through an intermediate vehicle (resident in State R) in which RCo holds a 20% interest. Under the convention between State R and State S, the withholding tax rate on dividends is reduced from 30% to 5%. Under the convention between State T and State S, the withholding tax rate on dividends is reduced to 10%. RCo pays tax and files tax returns in State R.

In determining which jurisdiction to locate the intermediate vehicle, the investors took into account a range of factors including State R’s tax convention network, and the certainty with regard to the tax treatment of interest and dividends, which is a commercial consideration given the scale and long term nature of these investments.

The Fund considered the existence of a benefit under the State R-State S tax convention with respect to interest and dividends, but this alone would not be sufficient to trigger the application of paragraph 7. The intention of tax treaties includes providing benefits to encourage cross-border investment. Therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. If a vehicle is established for purposes of providing finance for an infrastructure investment project, then after consideration of the facts and circumstances, it would not be reasonable to deny treaty benefits to the intermediate vehicle.

The conclusions of this example would apply equally if a fund invested through a series of separate entities as a regional platform. The principal purpose for the establishment of the regional platform should be considered with reference to the Fund’s economic and commercial nexus to the jurisdiction as a whole, rather than only on an ‘isolated’ entity-by-entity basis.
Example 3: Principal purpose to obtain treaty benefit: PPT not satisfied

The diagram below depicts an arrangement which we submit would not satisfy the PPT.

Background facts

- Three institutional investors, resident in Australia, New Zealand and Canada invest into R Co, located in State R.
- Collectively the three investors hold less than 60% and no one investor controls R Co. The remaining investors are also institutional investors.
- R Co is established to acquire an interest in an asset located in State S, which is held through an entity established in State S (“S Co”). R Co will co-invest with other investors into S Co.
- The commercial reasons for establishing R Co are the same as those set out in Example 1. In particular, a manager with specific expertise in managing the asset is located in State R, and the management team who work on the investment are all located in State R.
- State R is located in the same time zone as State S.
• The rate of dividend withholding tax between State S and State R under the DTA between these states is 10%.

• The domestic law of State S imposes a dividend withholding tax rate of 30% on dividends from S Co in the absence of a DTA.

• In order to mitigate this withholding tax leakage, R Co establishes a wholly-owned subsidiary in State L (L Co). The DTA between State S and State L provides a nil rate of dividend withholding tax. The rate of withholding tax on a dividend between State L and State R is also nil.

• Whilst L Co’s directors hold Board meetings in State L, none of the directors of L Co reside in State L. Furthermore, the management company in State R does not have any employees or presence in State L.

PPT analysis: DTA between State S and State L

Applying the PPT, it is clear on an objective analysis of all the facts of the arrangement that the principal purpose of establishing L Co was to enable R Co to obtain a lower rate of dividend withholding tax than would be available if it had made a direct investment into S Co from State R.

Based on the fact pattern set out above, an objective consideration of this arrangement leads to a conclusion that the establishment of L Co to invest into S Co can only be reasonably explained by a benefit which arises under the DTA between State S and State L. As such, we submit that the PPT would be failed in these circumstances.

Look-through analysis

Based on the facts above, we submit that an objective analysis of the facts surrounding the establishment of R Co leads to a conclusion that R Co was not established for a principal purpose of obtaining benefits under the State S-State R DTA.

Since the interposition of L Co fails the PPT, but the establishment of R Co does not fail the PPT, a “look-through” approach should be taken so that the treaty between State S and State R will apply to any distribution from S Co to R Co. As such, the prima facie rate of dividend withholding tax under the domestic tax law of State S (being 30%), should be reduced to 10%.

By way of illustration of the look-through principle, we submit that if a view was adopted that the establishment of R Co also failed the PPT (which is a position with which we disagree), then the look-through approach should be applied to the ultimate institutional investors, so that the DTA between S Co and Australia, New Zealand and Canada would be applied to the institutional investors resident in these jurisdictions.
April 22, 2016

BY E-MAIL: TAXTREATIES@OECD.ORG

Tax Treaties, Transfer Pricing and Financial Transactions Division
OECD/CTPA

Dear Sirs

Re: BEPS Action 6 – Treaty Entitlement of Non-CIV Funds

We are grateful for the opportunity to submit comments on the Public Discussion Draft – Treaty Entitlement of Non-CIV Funds released on 24 March 2016 (the “Discussion Draft”), which follows on from the Public Discussion Drafts in respect of BEPS Action 6: Preventing Treaty Abuse released in November 2014 and May 2015 (the “Action 6 Consultations”). We submitted comments on certain implications of the proposals described in the Action 6 Consultations for certain non-CIV funds in January and June 2015.

Ropes & Gray is an international law firm with approximately 1,100 lawyers worldwide. We represent a broad range of industry leaders across multiple practice areas, including a wide variety of investment funds.

We have limited our comments to certain specific questions raised by the Discussion Draft. For further detail on our views regarding the application of the Limitation-on-Benefits rule and the Principal Purpose Test for non-CIV funds, please refer to our previous responses to the Action 6 Consultations.

1. Background

Non-CIV funds (such as debt funds and private equity funds) are an important source of capital for businesses internationally. Investors in non-CIV funds will frequently include pension funds, insurance firms, other investment funds, sovereign wealth entities, not for profit entities (including charities and local authorities) and individuals. These investors choose to pool their capital through non-CIV funds for a variety of reasons. In particular, investors benefit from the expertise and market experience of professional managers, while the cost of the managers is spread across all of the investors in the fund.

Non-CIV funds are frequently organised as fiscally transparent entities. This ensures, among other things, that investors are taxed according to their own tax attributes, rather than those of an opaque fund entity. This principle of “tax neutrality” is an important feature of both non-CIV and CIV funds, as it ensures that investors who choose to pool their capital in funds are not left in a worse position from a tax perspective as a result of investing through the fund, as opposed to investing in the underlying assets directly. As
described below and in our previous responses, we are concerned that the Action 6 proposals might be interpreted as restricting the availability of treaty benefits for investment holding companies used by non-CIV funds in the ordinary course. If this were the case, it would prejudice the principle of tax neutrality of the fund and could negatively impact on the non-CIV fund industry, investors and recipients of capital.

2. Principal Purpose Test ("PPT")

Question 25 requests examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds.

As described in detail in our previous responses to the Action 6 Consultations, we are particularly concerned that the broad drafting of the PPT as currently proposed might be interpreted by some tax authorities as restricting the availability of treaty benefits to investment holding vehicles established by non-CIV funds.

A key difficulty with a PPT rule for non-CIV funds is the lack of certainty as to how it should be applied to structures commonly adopted by them. We do not think that the intention of the BEPS project is to upset established market practice in this area. We therefore welcome the suggestion that examples for non-CIV funds could be added to the Commentary to confirm that this is the intention, provided that those examples clearly reflect common commercial situations and do not include unascertainable or unusual features (a bad example could create more uncertainty than no example at all).

In addition, our view is that it is incumbent upon tax authorities to provide more detailed guidance prior to any treaty changes being adopted, particularly if they are taking the view that they will change their approach to common existing structures as a result of the treaty changes. If individual tax authorities do intend to change their approach, we would also emphasise our comments below under the heading “grandfathering” and urge that any change of approach be applied to new transactions only.

It is a legal and practical necessity for many non-CIV funds to establish investment holding vehicles. The reasons for establishing a holding vehicle are likely to include:

- ensuring the limited liability of the fund (and its investors) in respect of its investments;
- facilitating co-investment strategies (with either or each of management, other funds and strategic investors);
- facilitating external financing of investments (including bank finance); and
- centralising holding and administrative functions relating to investments, which may be in multiple jurisdictions.

In deciding where any such holding vehicles should be established, funds will naturally consider a wide range of practical, legal, regulatory and economic factors. However, as part of the general consideration of the legal and regulatory environment in a given
jurisdiction, funds will naturally also consider whether the jurisdiction in question has a suitable range of double tax treaties in place that are appropriate to the activities that will be conducted through the holding vehicles. The fact that a fund has taken such factors into account in this way should not, of itself, risk failing any PPT rule. If the view were taken that such consideration might breach a PPT rule, it would create an impact which is disproportionate to the treaty abuse risk posed by non-CIV funds. This is especially the case where a large proportion of investors in such non-CIV funds are likely to benefit from comparable treaty benefits in their jurisdiction of residence. Accordingly, we would welcome clarification that the PPT rule would not be breached in these circumstances.

Appendices 1 and 2 contain suggested text that could be used as examples to clarify that the ordinary course use of holding vehicles by private equity and debt funds, respectively, should not be considered to breach any PPT rule.

3. **Grandfathering**

One issue raised in our previous representations on these proposed measures (and which has not yet been addressed through the consultation process) is the question of grandfathering.

Market-standard transaction documents typically place “change of law” risk onto the recipients (rather than providers) of capital. For example, in the case of debt finance, the market standard documents will place the risk of any withholding taxes being imposed on the payment of interest (including as a result of a change in a double tax treaty) on the borrower. In the event that withholding is required, the borrower will be obliged to increase (or “gross-up”) the amount of interest payable to the lender such that, after the amount of any withholding has been deducted, the lender receives the same amount of interest as it would have received if no such withholding was required. Accordingly, in such cases, a borrower would be left with a choice between either paying a substantially higher rate of interest on its loans or refinancing its existing debt (which may be on less favourable terms depending on market conditions and is likely to result in payment of significant break costs).

It is important to bear in mind that any amendments to tax treaties that restrict the availability of treaty benefits to lenders in existing transactions are likely to result in significantly increased finance costs for the relevant borrowers. Accordingly, we would urge that any amendments to treaties that implement the OECD’s recommendations in respect of BEPS Action 6 should be subject to appropriate grandfathering for existing arrangements.

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1 See, e.g., the Loan Market Association’s precedent finance documents, the market-standard loan documentation for the European and Middle Eastern markets.
4. Limitation-on-Benefits ("LOB") rule

As explained in our previous responses to the Action 6 Consultations, in our view the application of the LOB rule to non-CIV funds would be a disproportionate response to the risk of treaty abuse actually presented by non-CIV funds and we would advocate a carve-out for non-CIV funds which is comparable to the proposed carve-out for CIV funds. However, in this submission, we focus on specific issues raised by Questions 20 and 21 of the Discussion Draft.

Questions 20 and 21 focus on elements of a proposed “derivative benefit” rule that seek to address concerns that have been raised regarding the potential for non-CIV funds to result in the deferral of income-recognition by investors. In effect, the proposal seems to require investors to recognise fund income on a current basis under a specific anti-deferral regime in order for that investor to qualify as an “acceptable” beneficial owner for purposes of the suggested 80% threshold.

Many jurisdictions have introduced anti-deferral regimes that tax investors resident in those jurisdictions in respect of their proportionate share of certain specific items of a fund’s income or gains. The Discussion Draft mentions the U.S. PFIC regime as an example of such a regime. A similar example would be the U.K. Offshore Funds regime. A common feature of these regimes is that they are highly complex and fact specific in their application. Exemptions are frequently made under such regimes for circumstances in which the jurisdiction of residence does not consider there to be a significant deferral risk.

For example, as a policy measure, the U.K. Offshore Funds regime makes specific exemption in respect of income arising to funds with an investment focus on unlisted trading companies. This broadly exempts traditional private equity funds from the scope of the Offshore Funds regime. Under the derivative benefits provision as currently framed, it would appear that any taxable UK investors in such a private equity fund would count against the fund in determining whether 80% of the fund’s investors are “acceptable” beneficial owners as such investors would not recognise income arising from the fund’s investments on a current basis for tax purposes.

In addition, anti-deferral regimes commonly would not apply in any case where the jurisdiction of residence of the entity claiming treaty benefits is the same as the investor’s jurisdiction of residence (as that jurisdiction would not perceive there to be a risk of deferral in such cases). Accordingly, these investors might not qualify as “acceptable” beneficial owners in such a case if an anti-deferral provision were to be included.

In our view, an unintended consequence of this proposal is that it might result in a denial of treaty benefits in exactly those situations where relevant jurisdictions have concluded that income deferral does not pose a significant concern (and have, therefore, provided a specific exemption under the relevant anti-deferral regime).
In our view, concerns regarding the deferral of income recognition are more effectively dealt with through the national law of the relevant jurisdiction of investor residence. Incorporating anti-deferral concepts into any derivative benefits provision could have significant unintended consequences.

We would, of course, welcome any opportunity to discuss the points raised in this letter and our previous responses to the Action 6 Consultations in further detail.

Yours faithfully

Ropes & Gray International LLP
Appendix 1 – Non-CIV Debt Fund Example

A non-CIV fund, structured as a fiscally transparent partnership, is established to invest in a portfolio of debt obligations. The fund may invest in debts in order to benefit from a regular income stream in the form of interest receipts or it may seek to invest in distressed or otherwise underperforming debts, in the hope of achieving a profit from a future repayment, or disposal, of the debts.

The fund manager or adviser is regulated and the fund is marketed to pension schemes, sovereign wealth funds, other institutional investors and high net worth individuals, on the basis of a prospectus that will become the investment mandate of the fund. On the basis of the track record of the fund manager/adviser, a variety of unrelated investors resident in different jurisdictions commit funds to the partnership without then knowing either the identity of the target investments or the specific jurisdictions in which the investments will be made (the prospectus may, however, indicate a broad geographical or sector-based investment focus for the fund). Similarly, the investment strategy of the fund is not driven by the tax position of the investors, but on the basis that it will seek to invest in a range of debt obligations offering a suitable return on capital.

Debt investments are made through a holding company, RCo, established in State R. It is likely that the investments held through RCo will include debt investments in jurisdictions that do not impose withholding taxes in respect of income and gains arising from debt investments, as well investments in jurisdictions that do impose such withholding taxes.

There are a number of reasons for establishing a holding company in order to make debt investments. There may, for example, be regulatory requirements arising in the jurisdictions in which loans will be made that make a corporate holding vehicle desirable. The fund may also wish to leverage the investors’ capital (either at the outset of the fund or at a later stage to be determined). Lenders providing finance will typically prefer to lend to a holding company, as this facilitates the grant of security over both the investment portfolio and the share capital of the holding company itself. Accordingly, the use of a corporate holding vehicle provides the fund with increased flexibility to utilise external leverage as a component of its investment strategy. If a fund intends to use external leverage for certain specific investments, the fund may set up a series of holding companies, each of which would hold separate investment portfolios, thus simplifying any financing arrangements.

In addition, borrowers typically expect to deal with lenders in corporate form. This is reflected in market-standard finance documents. Accordingly, the use of a corporate holding company facilitates both negotiations with new borrowers as well as the transfer of existing loans originated by other lenders on normal market terms.

Furthermore, by establishing a corporate holding company to make investments, the fund will benefit from the protection of the limited liability afforded to the shareholders in RCo.
In deciding on the location of the holding company, the fund manager considers the legal regime, political stability, investor familiarity, flexibility to extract proceeds from piecemeal realisations of the portfolio and tax considerations such as certainty around the taxation position of the holding company in respect of income from the portfolio and proceeds from the disposal of its investments. The treaty position of RCo in relation to a likely range of borrower jurisdictions is taken into account as part of the decision but this is only one factor in a range of considerations.

In making the decision to locate the holding company in State R, the fund manager did consider the existence of benefits under the tax conventions between State R and the states where potential borrowers might be resident, but this alone would not be sufficient to trigger the application of [paragraph 7]. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not [paragraph 7] applies to an investment, it is necessary to consider the context in which the investment was made. In this example, in the absence of other facts and circumstances showing otherwise, RCo’s investments are made for commercial purposes consistent with the investment mandate of the fund, and so RCo should receive treaty benefits. Therefore, unless RCo’s investments are part of an arrangement, or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the tax treaties between State R and any states which may seek to impose tax in respect of income or profits arising from RCo’s investments.
Appendix 2 – Non-CIV Private Equity Example

A non-CIV fund, structured as a fiscally transparent partnership, is established to invest in a portfolio of existing and unrelated trading businesses.

The fund manager or adviser is regulated and the fund is marketed to pension schemes, sovereign wealth funds, other institutional investors and high net worth individuals, on the basis of a prospectus that will become the investment mandate of the fund. On the basis of the track record of the fund manager/adviser, a variety of unrelated investors resident in different jurisdictions commit funds to the partnership without knowing either the identity of the target investments or the specific jurisdictions in which the investments will be made (the prospectus may, however, indicate a broad geographical or sector-based investment focus for the fund). Similarly, the investment strategy of the fund is not driven by the tax position of the investors, but on the basis that it will seek to invest in businesses with the aim of increasing their value and then realising this via an exit from the investment.

Investment in a target business is made directly or indirectly through an investment holding company, RCo, established in State R. The primary reason for the establishment of the holding company is the need to leverage the investors’ capital in order to finance the investment. The bank providing the finance will require that lending is made to a holding company in order that it can take security over both the target investment and the borrower entity itself by way of share pledges. In many cases, the security requirements of the financing bank may necessitate a chain of new holding companies to be established. For example, the banks may require downstream guarantees to be made from a parent company of the borrowing entity. For limitation of liability reasons, a fund will need to establish a further holding company to provide any such guarantee.

Even if external leverage is not desired for an investment, there may be a variety of further commercial reasons for establishing a new investment holding company for the investment. For example, this may be required to facilitate co-investment by third party investors or by investors in the fund who wish to advance further capital to a particular investment directly. In addition, private equity funds will typically introduce management equity arrangements to incentivise the senior management team of the target business. It may be more straightforward to achieve these commercial aims through a newly incorporated vehicle.

In deciding on the location of a holding company, the fund manager considers the legal regime, political stability, investor familiarity, flexibility to extract exit proceeds from a full or partial disposal of an investment and tax considerations such as certainty around the taxation position of the holding company on disposal of an investment. The treaty position of each of the target entities is taken into account as part of the decision but this is one factor in a range of considerations.

In making the decision to locate the holding company in State R, the fund manager did consider the existence of benefits under the tax conventions between State R and the states in which the target investment is resident, but this alone would not be sufficient to trigger the application of [paragraph 7]. The intent of tax treaties is to provide benefits to encourage cross-border
investment and, therefore, to determine whether or not [paragraph 7] applies to an investment, it is necessary to consider the context in which the investment was made. In this example, in the absence of other facts and circumstances showing otherwise, RCo’s investments are made for commercial purposes consistent with the investment mandate of the fund, and so RCo should receive treaty benefits. Unless RCo’s investments are part of an arrangement, or relate to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the tax treaties between RCo and the state in which a target investment is resident.
April 21, 2016

VIA EMAIL
Pascal Saint-Amans
Director
Centre for Tax Policy and Administration
Organisation for Economic Cooperation and Development
2 rue Andre-Pascal
75775, Paris
Cedex 16
France
(taxtreaties@oecd.org)

Re: USCIB Comment Letter on the OECD Discussion Draft on Treaty Entitlement of Non-CIV Funds

Dear Mr. Saint-Amans,

USCIB is pleased to submit these comments on the “BEPS Consultation Document on the Treaty Entitlement of Non-CIV Funds,” dated March 24, 2016 (hereafter, the “Discussion Draft”). We understand that the Discussion Draft was produced as part of the follow-up work on BEPS Action 6, which contemplates that the OECD would continue to examine the issues of tax treaty entitlement presented by non-CIVs. We also understand that the questions and proposals set forth in the Discussion Draft were raised by commentators and do not necessarily represent proposals of the OECD. This process makes providing comments difficult, especially given the short comment period. As a result, USCIB focuses on general principles rather than attempting to respond to particular proposals.

Most importantly, any proposed resolution should keep in mind that the goal of tax treaties is to encourage cross-border trade and investment.1 Rules that prevent legitimate investors from accessing benefits to which they are entitled run counter to this fundamental principle.

Investment funds should be understood to include all vehicles formed for the purpose of pooling capital contributed to the fund by diverse investors and investing that pooled capital in

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1 The BEPS project has been addressing instances of treaty-abuse that result in the elimination of tax in both the source and residence country. While addressing such concerns is appropriate, USCIB is concerned that the pendulum has swung too much in this direction and legitimate investors will be unable to access treaty benefits to which they are entitled. If this occurs, it will create a drag on cross-border trade and investment, which is undesirable in the best of times and counter-productive as the world economy continues to struggle with the after effects of the great recession.
investments, which investments can include stocks, bonds, other securities and other assets normally held by individuals and corporations for investment purposes. An investment fund will be managed by a manager or sponsor, who may or may not have a capital interest in the fund. Investors in private investment funds often include pension plans, endowments, and charitable foundations.

Although not stated explicitly in the Discussion Draft, we believe that the aim of a tax treaty pertinent to private investment funds should be to impose a final tax only once, at the level of the ultimate investor, at the treaty rate that such investor would be entitled to if he or she had invested directly in the underlying assets of the fund. The tax should be collected by the source country or the residence country (or split between them) depending upon the terms of the applicable treaty. We believe that any regulated, widely-held CIV, such as a US mutual fund or a European UCITS fund, should qualify as a treaty resident and as a per se “qualified person”.

In our experience, investment funds, particularly non-CIVs, are sometimes forced to choose a treaty-eligible vehicle simply to avoid duplicative taxation on their investors. For example, a U.S. private equity fund planning an investment in a European target company might in theory prefer to invest directly, if the source country would look through the fund and withhold only on the basis of the residence and entitlements of its partners. Unfortunately, many treaties do not permit this look-through treatment, or do so under circumstances that make it impossible to obtain certainty. In order to escape an extra level of taxation at the fund level, the fund will instead often invest through a European holding company, for example in Luxembourg, in order to avoid taxation at the fund level. Structuring these investments is complex. A better solution would be to implement a regime for looking through investment funds, as well as alternatives for those funds for which a look-through approach is not feasible.

We believe that the framework for private investment funds should include permitting such investment funds to receive proportional treaty benefits, to the extent that underlying investors in a fund would be entitled to treaty benefits if they had invested directly rather than through a pooled investment fund, as well as an equivalent beneficiary approach formulated to be of practical use. Accordingly, USCIB strongly supports the TRACE² project. Experts from countries and business have been working together for years in order to design and implement a system that would both improve compliance and allow taxpayers to claim treaty benefits at source. Implementing the results of the TRACE project -- in a reasonable and orderly time frame -- would go a long way towards achieving those goals, which would in turn alleviate at least some of the double taxation concerns that are raised by non-CIV investment funds. Nevertheless, even in the absence of implementation of the TRACE project, private investment funds are already required to gather detailed information about their investors under myriad regulatory requirements, including FATCA, UK CDOT and OECD CRS. On that basis, we support the adoption of a self-certification system, whether as formally part of the TRACE project or as an addendum to the other regulatory regimes listed above. To the extent that investment

² Treaty Relief and Compliance Enhancement Project.
funds have investors who are intermediaries, such intermediaries would be required to conduct similar diligence via the self-certification system.

Finally, while we note with approval the OECD’s recent efforts to resolve questions about the eligibility of pension funds to claim treaty benefits as “residents” of the State where they are organized, we also urge the OECD to find reasonable methods for ensuring that pension funds are not effectively denied treaty benefits because of onerous procedural requirements out of all proportion to the treaty abuse risk they pose. It is the norm that pension funds operate to provide a retirement investment vehicle and pension benefits for individuals who are resident in the State where the funds are created. There are a variety of factors (e.g., residence of the employer, employees’ need to invest for retirement through funds recognized as tax-favored retirement plans in their country of residence) that point towards very low risk of treaty shopping through pension funds. But procedures that require pension funds to obtain documentation from high numbers of participants or beneficiaries in order to “prove” their status as “qualified persons” pose costly and often unsurpassable barriers to legitimate claims for treaty relief. We urge the OECD to make particular efforts to find reasonable solutions to this growing problem.

Sincerely,

William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)

Sehr geehrte Damen und Herren,

ZIA, the German Property Federation (Zentraler Immobilien Ausschuss e.V.), represents German real estate business in its entirety, including real estate funds and real estate fund managers. ZIA speaks on behalf of individual member firms and 24 member associations, thus representing 37,000 branch members.

We are grateful for the opportunity to contribute again some remarks regarding access to treaty benefits for (non-CIV) funds.

Question 1: What would be the threshold for determining that a fund is “widely held” for the purpose of such a proposal?

With regard to our main subject, Real Estate Funds, we refer to Articles 6 and 13 paragraph 4 of the OECD Model Tax Convention on Income and Capital (MTC). These rules attribute taxing rights to the country where the immovable property is situated. Therefore, no income derived from immovable property will remain untaxed. So, the goal of the BEPS project – to avoid cases of double non taxation – will usually be reached regardless of where the investor is domiciled. This will be the case both if there is an individual investor or if the investment is made via a fund.

From our point of view it is inappropriate to require a real estate fund to be widely held, whatever the threshold would be.

To

Tax Treaties, Transfer Pricing and Financial Transactions Division

OECD/CTPA

By email only: taxtreaties@oecd.org

Berlin, 22 April 2016

Consultation on Treaty Entitlement of Non-CIV Funds

Ladies and Gentlemen,

ZIA, the German Property Federation (Zentraler Immobilien Ausschuss e.V.), represents German real estate business in its entirety, including real estate funds and real estate fund managers. ZIA speaks on behalf of individual member firms and 24 member associations, thus representing 37,000 branch members.

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From our point of view it is inappropriate to require a real estate fund to be widely held, whatever the threshold would be.
Question 2:
What types of regulatory frameworks would be acceptable in order to conclude that a fund is “regulated” for the purposes of such a proposal? For instance, would these include the types of regulatory requirements described in paragraph 16 of the 2010 CIV report (... controlling interest in a company ...) as well as disclosure requirements relating to distribution of interests (e.g. “know your customer” rules)?

Fund regulation varies in principal from country to country, sometimes in part aligned by supranational agreements (e.g. Alternative Fund Managers Directive, European Union). Contracting states should be encouraged to grant treaty access to non-CIV funds wherever national regulations are comparable or based on the same supranational agreement.

Nevertheless, all possible requirements should be adapted to the nature of the investment. With regard to real estate funds it should be recognised that typically the fund holds 100% in all the companies it invests in. Often e.g. investments abroad require this kind of structure. So, it would be counterproductive to limit controlling interests of real estate funds in real estate companies.

We refer again to Article 6 and Article 13 paragraph 4 MTC and the underlying principle of taxing revenues or capital gains deriving from immovable property in the country, where the immovable property is situated.

Question 7:
Where an entity with a wide investor base is treated as fiscally transparent under the domestic law of a State that entered into tax treaties, the application of the relevant tax treaties raises a number of practical difficulties. Are there ways in which these difficulties could be addressed? Are there other practical problems that would prevent the application of the new transparent entity provision in order to ensure that investors who are residents of a State are entitled to the benefits of the treaties concluded by that State?

For practical reasons funds with a wide investor base should be granted treaty access as far as possible. Where no other requirement seems appropriate, requiring a high proportion of investors that would have treaty access themselves may be sensible.

Where national law treats a widely held fund as opaque and possibly subject to corporate income tax, the fund should have treaty access without further restrictions.

Transparent funds should always have the possibility to claim treaty benefits on behalf of all investors that would have treaty access had they invested directly.
We emphasise that any investor investing via a fund should – as far as possible – eventually be treated in the same way as an investor investing directly in that asset. The after tax result of the investment should be the same in both cases.

With kind regards

Dr. Stephan Rabe
Chief Executive Officer

Roland Franke
Head of Department
Financial Markets Regulation & Taxes