efama
European Fund and Asset Management Association

TO: Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA

Sent via e-mail: taxtreaties@oecd.org

22 April 2016

Dear Sirs,

PUBLIC DISCUSSION DRAFT – TREATY ENTITLEMENT OF NON-CIVS

EFAMA[1] 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

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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 trough 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?***

- ***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?***

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,

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EFAMA