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By Electronic Delivery

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Marlies de Ruiter
Head of Division
Tax Treaties, Transfer Pricing and Financial Transactions
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development
2, rue André Pascal - 75775 Paris Cedex 16

RE: *CIVs and Follow-Up Work on BEPS Action 6 (Prevent Treaty Abuse)*

Dear Ms. de Ruiter:

ICI Global[1] supports strongly the work done over the past ten years by the OECD and its members to improve treaty access for collective investment vehicles (CIVs) and their investors. We also support strongly both (1) the CIV Report[2] that was produced by the Informal Consultative Group (ICG) in which we participated actively and (2) the inclusion of the Report's conclusions in the 2010 Update to the OECD Model Tax Convention Article 1 Commentary.[3] The Commentary developed in the Report provides alternative approaches by which individual investors in all CIVs, regardless of the manner in which a CIV is organized, operated, or distributed, can receive treaty relief. More specifically, these CIV investors have the opportunity to receive the same treaty relief that they would receive had they invested directly in the securities held by the CIV.

Turning to BEPS Action 6, we appreciate greatly that the comments we submitted on 8 April 2014 regarding BEPS Action 6 and Treaty Benefits for Collective Investment Vehicles[4] were

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[1] The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$19.2 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

[2] The CIV Report more precisely is entitled "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" and is available on the OECD's website at www.oecd.org/tax/treaties/45359261.pdf.

[3] http://www.oecd.org/tax/treaties/45689328.pdf.

[4] http://www.ici.org/pdf/28024.pdf.

incorporated fully in the Action 6 2014 Deliverable.[5] We also appreciate that the Deliverable includes, on pages 72-73, one example of a CIV investment that would not raise principal purpose test (PPT) concerns.

This letter responds to questions asked in the Public Discussion Draft regarding Follow Up Work on BEPS Action 6: Preventing Treaty Abuse[6] that was released on 21 November 2014. We appreciate this opportunity to share our views and look forward to discussing them during the public consultation on 22 January 2015.

Background

ICI Global's comments are limited to those investment funds that are the subject of the OECD's CIV Report. Specifically, our comments address only "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."[7]

The benefits provided by these funds, as the CIV Report notes, include: "allow[ing] small investors to gain the benefits of economies of scale;" "provid[ing] access to a number of markets that might be closed to the small investor;" providing a "highly liquid" investment; and allowing for "highly efficient reinvestment of income."[8] CIV investors also "benefit from the market expertise and insights of professional money managers" and receive "the benefits of diversification that otherwise would require much greater investment."[9] Consequently, the CIV Report notes, "Governments have long recognized the importance of CIVs as a complement to other savings vehicles in terms of facilitating retirement security."[10]

To achieve these benefits efficiently, domestic tax laws effectively provide that a CIV's income is taxed only once: in the hands of either the CIV or its investors. This "no additional level of tax" feature helps provide CIV investors with tax treatment that is roughly comparable to that received by a direct investor in securities.

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[5] http://www.oecd.org/tax/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-9789264219120-en.htm.

[6] http://www.oecd.org/ctp/treaties/discussion-draft-action-6-follow-up-prevent-treaty-abuse.pdf.

[7] *See,* CIV Report, page 3, paragraph 4. Our comments do not address "investments through private equity funds, hedge funds or trust or other entities that do not fall within the [Report's] definition of CIV." *Id.*

[8] All quotes in this sentence are from CIV Report, page 4, paragraph 8.

[9] The quotes in this sentence are from CIV Report, page 4, paragraph 9.

[10] CIV Report, page 4, paragraph 10.

Issues Related to the LOB Provision

Question 1: Collective Investment Vehicles: Application of the LOB and Treaty Entitlement

Support for the CIV Report

ICI Global submits that the recommendations of the 2010 CIV Report are sound. No improvements should be made to the conclusions included in the Report. Moreover, we submit that it would not be advisable to provide a "preferred approach" for CIV tax treaty entitlement issues and the application to CIVs of a limitation on benefits (LOB) provision. Each of these conclusions is explained in detail below.

The CIV industry, beginning with a 2005 meeting of Working Party 1 at which we were one of the invited business representatives, has supported enthusiastically the OECD's work on CIV treaty entitlement. This work was undertaken because various differences in CIVs' legal form and tax treatment were generating starkly different treaty entitlement results. These differing results led to reciprocity concerns and denial of treaty relief for CIVs that clearly qualified as persons, residents, and the beneficial owners of their income.

The Report expressly recognized that "differential treatment could be seen as violating the general policy goal of treating economically similar structures similarly."[11] This result of differential treatment also could be viewed as "possibly violating the implicit assumption of reciprocity."[12]

To achieve neutrality between CIV investors and direct investors on the one hand, and between investors in different types of CIVs on the other hand, the Report correctly provided alternative approaches for providing treaty relief. Those CIVs that meet the treaty requirements should receive treaty relief in their own right. Other CIVs should be allowed effectively to claim treaty relief on behalf of their eligible investors (including by treating a CIV as transparent so that pension funds, for example, receive any applicable exemption). As the Report noted, "[d]eveloping practical solutions that ensure that the CIVs that are common in each jurisdiction have access to treaty benefits, even if on different terms, is likely to be more beneficial for both countries in the long run."[13]

The practical procedures for establishing the treaty eligibility of CIV investors is another key aspect of the CIV Report. If all CIVs were treated identically, CIVs that are distributed only in their country of residence and are subject to tax rules that make them generally unattractive to nonresident investors most likely would suffer. As the Report notes, it may be appropriate in this case to treat the CIV as satisfying any applicable limitation on benefits provision without further examination because the CIV's investors will reside predominantly if not exclusively in the CIV's residence country. Importantly, even when proof of the treaty eligibility of a CIV's investors is

[11] CIV Report, page 13, paragraph 50.

[12] *Id.*

[13] CIV Report, page 13, paragraph 51.

required, the CIV Report states that this proof generally should be required only annually and never more frequently than quarterly.

"Practical and reliable" approaches for identifying investors also should be provided. Practical approaches are necessary as a CIV may have tens or hundreds of thousands of individual investors. Moreover, as the Report notes, CIV interests "acquired through intermediaries often are registered at the CIV level through nominee/street name accounts."[14] In this situation, only the intermediary (*e.g.,* the broker) knows the treaty eligibility of its customers. Ensuring reliable treaty-eligibility claims in this situation was addressed by the OECD in its Treaty Relief and Compliance Enhancement (TRACE) implementation package[15] – which we support unequivocally and for which we urge prompt adoption.

Equally importantly, the Report recognized that a CIV distributed cross-border (*e.g.,* a "globally-distributed CIV") would be disadvantaged unless all of its investors who are resident in countries with which the source country provides comparable treaty relief are treated as "eligible" investors for treaty-entitlement and LOB purposes. CIVs organized in Europe under the UCITS Directive, for example, typically are distributed widely in European countries that have broad treaty networks.

The equivalent beneficiary standard, the CIV Report notes,

> serves the goals of neutrality as between direct investments and investments through a CIV. It also decreases the risk of double taxation as between the source State and the State of residence of the investor to the extent that there is a tax treaty between them. It is beneficial for investors, particularly those from small countries, who will consequently enjoy a greater choice of investment vehicles. It also increases economies of scale, which are a primary economic benefit of investing through CIVs. Finally, adopting this approach substantially simplifies compliance procedures.[16]

Equivalent beneficiary treatment is essential to ensuring appropriate treaty relief for investors in globally-distributed CIVs.

Specific ICI Global Recommendations on CIVs, Treaty Entitlement, and LOB

ICI Global supports strongly the position taken in the BEPS Action 6 2014 Deliverable to incorporate the conclusions of the CIV Report. Most particularly, we support the alternative approaches for determining treaty eligibility that are reflected in the BEPS Action 6 2014 Deliverable; these alternatives are essential to providing neutrality between different types of CIVs and between CIVs and direct investment. The legal and tax treatment differences between CIVs preclude a "preferred approach." If a revised BEPS Action 6 paper included a "preferred approach,"

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[14] CIV Report, page 6, paragraph 18.

[15] http://www.oecd.org/ctp/exchange-of-tax-information/TRACE_Implementation_Package_Website.pdf.

[16] CIV Report, page 14, paragraph 35.

treaty relief for investors in any CIV that is treaty-entitled in its own right and distributed only in the CIV's country of residence surely would be restricted.

Any LOB clause should be applied appropriately to CIVs to maximize the value to CIV investors of the many benefits that CIVs provide.[17] To that end, we support strongly including an equivalent beneficiary standard in any LOB. Limiting treaty relief to those CIVs distributed only within the two treaty partners would lead to double taxation and the inequitable results discussed above. Globally-distributed CIVs, investors in small countries, and others would be harmed.

Question 2: Non-CIV Funds: Application of the LOB and Treaty Entitlement

Non-CIV Investment Funds

The CIV Report did not consider other types of funds, such as alternative and private equity funds, because they present treaty entitlement issues different from those presented by CIVs. As the OECD's Informal Consultative Group process worked well, in the CIV context, to identify issues and develop practical solutions, it would be appropriate to pursue a similar approach for non-CIVs. Because of differences between CIVs and other investment vehicle types, however, any work on non-CIVs should not impact the CIV Report or its conclusions.

Pension Funds

Pension funds, whether they invest in CIVs or not, present unique treaty-entitlement issues. As noted above and in the CIV Report, the treatment of pension funds that invest through CIVs has been considered. The CIV Report included recommendations that would treat a CIV held by a relatively small number of pension funds as transparent and permit direct tracing of the CIV's income to its (generally exempt) investors. This treatment would maximize the benefit to a pension fund and its participants/beneficiaries of all relevant treaty provisions.

Pension funds, like CIVs, promote important social goods – including long-term financial security. Countries benefit when their senior citizens have sufficient assets to support themselves without relying upon publicly-funded assistance programs (whether or not designed specifically for the elderly).

The tax-favored treatment typically provided to pension funds (such as no taxation on the fund's income or assets) enhances the amounts available to the fund's pensioner beneficiaries. Countries limit the types of pension funds and other retirement arrangements that receive this favorable treatment to prevent the benefits from being abused.

One illustration of the conscious decision to treat pension funds as non-abusive is the treatment provided by the United States to implement the Foreign Account Tax Compliance Act (FATCA); the favorable treatment was provided both by regulations and in the Intergovernmental Agreements (IGAs) that the US negotiated with other countries. By treating pension funds as

[17] Any PPT likewise should be applied appropriately to CIVs. We discuss PPTs in our response to Question 17, below.

"deemed compliant" financial institutions, the US Government effectively provided that they cannot be utilized by individuals for abusive tax purposes.

One starting point for defining the term pension fund would be the Commentary to the Common Reporting Standard (CRS).[18] The Commentary, drawing from FATCA, includes within the definition of "non-reporting financial institution" a Broad Participation Retirement Fund, a Narrow Participation Retirement Fund, and a Pension Fund of a Governmental Entity, International Organization or Central Bank. While maximizing definitional consistency between BEPS Action 6, the CRS, and TRACE should be an important goal for these related initiatives, crafting appropriately-inclusive rules also is important. To that end, plan participants resident in any country with which the source country provides a pension fund exemption should be treated as "good" for any definitional purpose (such as the Narrow Participation Retirement Fund rule that not more than 20% of the fund's assets be held by non-residents).

We question whether the treaty eligibility of a pension fund that meets the applicable requirements for tax-favored treatment in its country of residence should be subjected to LOB (or a PPT). As pension funds perform an important social role and provide little if any ability to be used for tax avoidance purposes, they generally should receive the maximum possible treaty relief benefit; this relief should be restricted only in narrowly-defined situations in which the abuse potential is significant.

We observe that whenever the pension fund, its participants, and beneficiaries all reside in the same country, any potentially-applicable LOB (or PPT) clause would have no practical effect. This "no impact" situation presumably would apply to any pension fund organized by a business operating only within a single country.

When a business operates across borders, however, additional complexities may arise. A global business that creates a single pension fund, for example, presumably would have as participants and beneficiaries individuals resident in every country (and perhaps more) in which the firm conducts business. Treaty-eligibility issues also might arise if the business organized a separate pension fund for each country in which it operates. Employees working in one country, who are nationals of another country, might retire and move back home – thereby becoming non-resident beneficiaries for treaty purposes. Moving back home, however, should never cause a pension fund to lose its exempt status.

In sum, we recommend that:

- A tax exemption be provided for a pension fund's portfolio investments;
- A pension fund be defined broadly for this purpose;
- LOB (and PPT) clauses (or any other "anti-abuse" rule) be applied narrowly, if at all, to pension fund cross-border investments; and
- Any LOB should treat as "good" participants/beneficiaries any person who is resident in any country with which the source country provides a pension fund exemption.

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[18] http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm

Questions 4-6 – LOB and the EU, Intermediate Owners and Derivative Benefits

ICI Global recommends that treaties be applied to CIVs by treating all equivalent beneficiaries as residents of a treaty partner and by looking through any street name/nominee account to the underlying investors.

Adopting the equivalent beneficiary approach included in the CIV Report, for the reasons discussed in the response to Question 1, will address CIV concerns with certain European Union law requirements. Any derivative benefits rule that limits treaty eligibility to a company with a fixed number of equivalent beneficiaries (*e.g.,* seven) should not apply to CIVs that, as defined in the CIV Report, are widely held.

Likewise, any rule applicable to "intermediate owners" should reflect the fact that banks, brokers, and others holding CIV interests for their clients in street name/nominee accounts do not "own" the interests even if they have legal title to them. Beneficial ownership principles – in which the street name/nominee account "owner" is acting merely as an agent – should be applied to determine who owns CIV interests for LOB purposes. The status of a nominee as resident in a non-treaty jurisdiction should not prevent its customers residing in treaty-partner jurisdictions – whose assets were used to purchase the CIV interests – from being treated as the owners for LOB purposes; information regarding these underlying owners would be available to any country that adopts TRACE.

Questions 7-9 – Publicly-Listed Entities

CIVs that trade on recognized stock exchanges should be eligible for any treaty relief provided to publicly-listed entities. A CIV that is treaty-entitled in its own right and that trades on a stock exchange in its residence jurisdiction should satisfy the publicly-traded LOB (without regard to the number of its investors) by applying the CIV Report's equivalent beneficiary approach. Trading on exchanges in multiple jurisdictions should not impact negatively a CIV's ability to rely on the publicly-listed rule; CIVs are listed on multiple exchanges to facilitate the availability of CIV interests to investors of moderate means. If a CIV is not listed on an exchange of its residence country, and claims treaty benefits on behalf of its investors (rather than in its own right), it likewise should be able to claim relief by applying the CIV Report's equivalent beneficiary approach.

Questions 12-14 – PPT Rule Relief

A PPT applied unilaterally by a government could create substantial uncertainty for CIVs. As discussed in the CIV Report, CIVs have a keen interest in tax certainty as they typically must determine each day the value of their assets and liabilities to price their CIV interests. For a CIV to price its interests, it needs to know each day how much foreign tax it will owe on the income and gain from its cross-border investments.

We submit that a PPT should be applied only upon the agreement of both Contracting States. At a minimum, effective and expeditious mechanisms for reviewing PPT application – such as administrative procedures that involve committees of experts and mandatory arbitration – are essential for CIVs to gain the requisite certainty. These mechanisms serve at least two purposes. First, their availability may limit inappropriate application to CIVs of a PPT. Second, when a PPT

is applied inappropriately, these mechanisms – particularly if they are applied expeditiously – will shorten the period of uncertainty.

We support strongly mechanisms for resolving unilateral application of a PPT. These mechanisms will assist CIVs in ascertaining expeditiously their tax liabilities on cross-border investments.

<u>Question 17 – List of examples in the Commentary on the PPT Rule</u>

We also recommend that CIVs generally be exempt, expressly or effectively, from any principal purpose test. Example D, on pages 72-73 of the BEPS Action 6 2014 Deliverable, provides an excellent starting point for effecting this recommendation. The CIV in this example makes investment decisions that "take into account the existence of tax benefits provided under [the CIV's residence country's] extensive tax convention network." Taking into account a treaty between the CIV's residence country and a country in which the CIV invests, the Example states, "alone would not be sufficient to trigger [the PPT]. Because "[t]he intent of tax treaties is to provide benefits to encourage cross-border investment . . . it is necessary to consider the context in which the investment was made." In conclusion, the example provides, "unless [the CIV's] investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining [treaty benefits], it would not be reasonable to deny the benefit of the . . . treaty to [the CIV].

While very helpful, this example's application is limited because it assumes: (1) that a majority of the CIV's investors are resident in the CIV's country of residence and (2) the CIV distributes annually to investors almost all of its income and pays residence-country tax on any amounts retained. The example, on its face, does not apply to most globally-distributed funds or to any fund (even if distributed only within a single country) that retains, rather than distributes, its income.

We recommend that any final report on BEPS Action 6 include a second example in which a majority of the CIV's investors are resident in any country with which the source country provides treaty relief comparable to that provided to the treaty partner. This recommendation effectively would embed into the PPT the equivalent beneficiary approach that we submit is essential to provide appropriate treaty relief to globally-distributed CIVs.

We likewise recommend that the example apply to a CIV that retains, rather than distributes, its income. Without this change, the investors in a "non-distributing" CIV will suffer double taxation – first when the CIV receives income and a second time when the investor disposes of his/her CIV interest. At a minimum, an example with the assumptions we recommend above should be provided for those countries that support equivalent beneficiary treatment and seek to prevent double taxation (as opposed to preventing only double taxation that occurs within a single year).

Our recommendations are being advanced because the widely-held CIVs covered by the CIV Report and the BEPS Action 6 2014 Deliverable are designed to assist individual investors, particularly those of moderate means, in saving for long-term needs such as retirement. Globally-distributed CIVs, as discussed above, serve a wide range of important objectives; tax manipulation is not one of them. Any concern about potentially abusive arrangements should be addressed by including in the PPT examples a specific illustration of the concern; one such concern would be a CIV organized in a treaty country and distributed predominantly, and purposefully, only within countries that do not have treaties with the source countries in which the CIV invests. Factors that

would support this abusive principal purpose would include: (1) an investment objective that targets countries with which the expected investor base does not receive treaty relief; and (2) promotional materials that highlight the ability to receive treaty benefits that would not be received by investing in the source countries directly or through other investment vehicles.

TRACE

The TRACE implementation package approved by the OECD's Committee on Fiscal Affairs in January 2013 provides many important tools for combating tax treaty abuse. Importantly, TRACE's investor documentation and reporting mechanisms will provide countries with additional assurances that the claims investors make for treaty relief are appropriate. Authorized intermediaries, having entered into agreements with source countries to provide accurate information and have their compliance procedures examined by an independent reviewer, will be strong partners in preventing treaty abuse.

We urge that countries adopt TRACE as they implement other investor-related initiatives (including any arising from BEPS Action 6). TRACE is beneficial because it will both enhance the effectiveness of treaty-abuse initiatives and reduce situations in which two countries tax the same income amount; reducing double taxation, after all, is the primary reason for negotiating treaties.

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Please feel free to contact me (at lawson@ici.org or 001-202-326-5832) at your convenience if you would like to discuss this issue further or if we can provide you with any additional information. My colleagues Karen Gibian (at kgibian@ici.org or 001-202-371-5432) and Ryan Lovin (at ryan.lovin@ici.org or 001-202-326-5826) also may be called upon for assistance.

Sincerely,

/s/ Keith Lawson

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