"Ensuring Appropriate Treaty Relief for CIVs"

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I. Introduction

Ensuring appropriate treaty relief for collective investment vehicles (CIVs)\(^1\) is more important than ever. Worldwide, CIVs have seen tremendous growth in assets over the past two decades.\(^2\) This growth has been driven by investor demand for professionally managed and well-diversified products offering access to global capital markets. The volume of cross-border investments made through CIVs underscores the importance of ensuring appropriate treaty relief for CIV investors.

Although multinational organizations and governments support ensuring that CIV investors receive the treaty relief to which they are entitled, tremendous scrutiny of treaty relief claims exists in some countries. This scrutiny arises, to some extent, from the increased focus on the financial services industry after the financial crises in 2008, several publicized tax scandals, and the increasing revenue pressures felt by governments.

The discussions around treaty eligibility generally focus on the need for tax certainty, neutrality, and practicality. Certainty, in some respects, is the most important theme. CIV interests, as explained below, typically trade based on the net value of the CIVs’ assets (including the value of their outstanding tax claims); the greater the uncertainty regarding recovering the tax reclaim amount, the more difficult the valuation process. Firms, such as custodian banks, filing treaty relief claims for clients likewise want certainty as governments will look to them first for any under-withholding. Finally, governments want certainty that treaty claimants are in fact eligible for any tax relief provided.

The importance of neutrality between direct and CIV investors in receiving treaty benefits is recognized by most countries. Governments have incentives to ensure that CIV investors receive appropriate treaty relief. Treaties would be less useful if relief effectively were restricted to direct

\(^1\) CIVs are defined for purposes of this paper 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. This is the definition included in a report (known as the CIV Report) that was finalized in 2010 by the Organisation for Economic Co-operation and Development (OECD). Funds that are not treated as CIVs in the CIV Report include “investments through private equity funds, hedge funds or trusts or other entities do not fall within the [CIV Report’s] definition of CIV.” See, The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles, \url{https://www.oecd.org/tax/treaties/45359261.pdf} (last accessed 15 March 2019).

\(^2\) The worldwide net assets of so-called open-end CIVs (the interests in which are continuously offered and redeemable upon demand) totaled US$50.1 trillion on 30 September 2018. See, Worldwide Regulated Open-End Fund Assets and Flows, Third Quarter 2018, Investment Company Institute, \url{https://www.ici.org/research/stats/worldwide/ww_q3_18}.\n
investors who typically are wealthier and more sophisticated financially. CIV investors, who are of more modest means and often saving for retirement, should not be worse off.

Practical approaches for receiving the treaty relief negotiated by a CIV’s government are essential. Treaty relief is provided either when the income is received (“at source” relief) or only after an investor’s filed claim to recover excess withheld tax is accepted (“reclaim” relief). The process of claiming at-source relief generally is much simpler and less expensive than the process of filing reclaims. Indeed, in some countries, the treaty reclaim process can take years and requires the assistance of local counsel. In too many cases, CIVs effectively are forced to forgo treaty benefits because the reclaim process is overly burdensome.

The Organisation for Economic Co-operation and Development (OECD) has made considerable progress in advancing governments’ understanding of ways to simplify the treaty relief process for CIVs. The OECD’s Informal Consultative Group (ICG) on the Taxation of CIVs and Procedures for Tax Relief for Cross-Border Investors, consisting of government and business representatives, prepared a report that was approved by the OECD’s Committee on Fiscal Affairs in 2010 and incorporated into the OECD’s Commentary on their Model Income Tax Convention. The ICG’s CIV Report also recommended “best practices” regarding procedures for making and granting claims for treaty benefits for intermediated structures more generally.

Broad support for the CIV Report has been received from industry and governments. The OECD Base Erosion and Profit Shifting (BEPS) Action 6 Final Report3 on treaty abuse, for example, effectively incorporates the CIV Report’s recommendations and conclusions.

Unfortunately, however, support for the CIV Report has not led to the desired sea change in treaty application. While some countries have recently clarified CIV treaty eligibility, the number of treaty-related disputes has increased as well.

This paper provides background information, examines the relevant tax policy considerations and issues faced currently by CIVs, and proposes solutions to ensure appropriate treaty entitlement.

II. Background

Collective Investment Vehicles (CIVs): In General

CIVs typically are organized by an investment manager that manages the CIV’s assets. In a “domestically marketed CIV,” the manager and essentially all of the CIV’s investors are located in the same country. In a “globally marketed CIV,” as the name implies, the CIV’s investors are disbursed widely across numerous countries. The factors that CIV managers consider in deciding where to organize a CIV include the manager’s domicile, the targeted investor base, the CIV’s investments, and a country’s regulatory framework.

Because CIVs are widely held with a constantly changing shareholder base, it is not possible to attribute a proportionate amount of any income item to any specific investor. One CIV typically will have many thousands, sometimes hundreds of thousands, of individual investors. CIVs, unlike many other types of investment funds, also may be purchased and sold every day. Even if an investor does not purchase shares on a given day, his or her proportionate interest in the CIV will change as the CIV experiences net purchases or sales of its shares.

CIVs include “open-end” funds (such as UK unit trusts, EU UCITS,4 and US mutual funds), closed-end funds, and exchange-traded funds (ETFs). Shares5 in open-end CIVs are bought from and sold to the CIV each day. Shares in closed-end funds and ETFs, in contrast, typically are bought and sold on exchanges. Open-end CIVs are purchased and sold at the CIV’s net asset value (NAV), which is determined every day. Closed-end funds and ETFs, in contrast, trade on exchanges at market prices that may or may not closely reflect the underlying NAV (which typically also is published daily).

NAV is calculated by dividing the current market value of the CIV’s assets (minus liabilities) by the number of shares outstanding. Because a CIV’s assets include expected tax relief, valuing accurately the expected relief is important for NAV calculation accuracy. An incorrect NAV causes investors to pay or receive too much or too little for their shares.

CIVs will “book” a treaty claim—meaning, include it as an asset “receivable”—when a sufficiently high probability exists that the amount will be recovered. Situations arise, however, when treaty claims that “should” be honored will not be booked or will be reversed after inclusion as a CIV asset. The most common situations are when a source country either (1) changes its position, such as because of reciprocity concerns,6 (2) imposes requirements that cannot be met as a legal or practical matter,7 or (3) provides relief only if claimed at source (and a CIV has not completed the required paperwork before the dividend is paid8).

Investors who acquire CIV shares may have their ownership reflected directly on the CIV’s books and records (which typically happens when the shares are purchased directly from the CIV) or instead

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4 UCITS stands for Undertakings for Collective Investment in Transferable Securities.

5 Depending on the legal form in which a CIV is organized, its investors may acquire “shares,” “units,” or “interests.” For simplicity, we will use only one term: “shares.”

6 In one very difficult situation that created significant uncertainty for several years, a source country denied treaty benefits to an entire country’s CIVs to force a discussion with the treaty partner’s tax authorities regarding the treaty eligibility of the source country’s own CIVs.

7 CIVs, for example, are prevented by data privacy and confidential business information considerations from complying with requirements to provide names and addresses for all investors.

8 Some countries require a taxpayer to provide a certificate of residence (COR) that must be issued by the residence country tax authority prior to the dividend payment date; tax authorities often struggle to issue CORs in a timely manner, particularly for dividend payment dates early in a calendar year.
through an “omnibus” or “street name” account. Customer identification, recordkeeping, and tax reporting typically will be performed by the financial institution (such as the CIV’s manager or the intermediary) that has the business relationship with the client.

In an omnibus situation, the registered owner of the shares is a nominee or intermediary (such as a bank, broker-dealer, or financial planner) that holds the shares for its customers. Importantly, CIVs often do not know the identities of the individual investors whose interests are held through these street name accounts. Competitive concerns often cause intermediaries not to disclose their customers’ identities—which have substantial commercial value. This intermediated structure makes it very difficult, if not impossible, to make certifications regarding the tax status of individual investors or to provide withholding tax information to each individual investor so that may make their own treaty claims.

*Governmental Concerns*

Governments generally want to achieve parity between investors who invest through CIVs and those who have the means and sophistication to invest in securities directly. For this parity to exist, an investor should receive the same treaty benefits whether he or she invests through a CIV or holds directly the same assets that are held by the CIV.

Some countries have sought to guard against perceived treaty abuse by incorporating into their treaties anti-treaty-shopping provisions (or by implementing such policies through procedure mechanisms). Such measures seek to determine whether the owners of a CIV are residents of the country in which the CIV is organized. In some cases, countries also will provide relief to the CIV to the extent that its owners are residents in other countries with which the source country provides equivalent treaty benefits.

### III. Intergovernmental Developments

The OECD, recognizing the complex treaty issues for CIVs, has worked to develop an international consensus for ensuring the CIV investors receive appropriate treaty relief. The OECD’s 2010 CIV Report recognizes that CIVs take different legal forms, are distributed in different ways, and operate under different requirements for making (or not) distributions to investors. These differences can be important to treaty negotiators when determining whether a CIV itself is entitled to treaty relief (including after application of limitation on benefit [LOB] rules, such as those in US tax treaties) or whether treaty relief must be based, instead, upon the eligibility of the CIV’s investors.

The United Nations (UN) Committee of Experts on International Cooperation in Tax Matters (Tax Committee) is also concerned with treaty entitlement issues for CIVs. The UN Tax Committee of Experts is currently undergoing a project to determine whether CIVs should be separately addressed in the next update to the Commentary for the UN Model Income Tax Convention.
Applying Model Income Tax Conventions to CIVs

The OECD Model Tax Convention (OECD Model), which is the basis on which about 3,000 bilateral tax treaties worldwide have been negotiated, does not have any specific provision for CIVs. Therefore, a CIV must satisfy the standard treaty rules and establish that it is: 1) a person, 2) a resident of a contracting state, and 3) the beneficial owner of the income it receives. Guidance on how these rules should apply to CIVs was included, following the CIV Report’s adoption, in the Commentary to the OECD Model.9

Whether a CIV is a “person” depends on its legal structure.10 The CIV Report explains that some CIVs clearly are persons because they are companies.11 On the other hand, a mere form of joint ownership (such as a contractual fund) clearly is not a person for treaty purposes.12 It is less clear whether a CIV organized in trust form is a “person” for treaty purposes. The CIV Report observes that the fact that the tax laws of the country where the trust is established treat it as a taxpayer would be indicative of “person” status.13 The CIV Report advises treaty negotiators to consider modifying the definition of “person” in treaties to specially include such trusts.14 This clarification is important with respect to certain countries, particularly civil law countries, that may not recognize the trust concept in their domestic law.

“Resident” generally is defined in Article 4 of the OECD Model as a “person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criteria of a similar nature.” The Commentary to the OECD Model and the CIV Report provide that a person may be liable to tax, and therefore a resident, even if tax is not imposed on that person. Specifically, the CIV Report notes that a CIV that is transparent for tax purposes in the country in which it is established will not be treated as a resident because it is not liable to tax in that country, nor will a CIV that is totally and unconditionally exempt from taxation (e.g., without regard to the type of income it receives or its distribution policy).15 On the other hand, a CIV that is treated as opaque in the country in which it is established will be treated as a resident even if the specific items of income it receives are exempt for taxation, or it receives a deduction for dividends paid to investors, or it is subject to a lower rate of tax on its income.16

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10 CIV Report, para. 23.

11 Ibid. para. 25.

12 Ibid.


14 Ibid.

15 Ibid. para. 29.

16 Ibid.
The third general treaty-eligibility requirement demands that the claimant be the “beneficial owner” of its income, although the term is not defined in the OECD Model. Instead, this requirement turns on how the term is defined under the local law of the country where the investment is made, even if the taxpayer’s country of residence would take the opposite view.17 This last requirement, in many respects, is the most difficult for CIVs.

The CIV Report urges countries to treat CIVs as the beneficial owners of their income so long as the managers of the CIV have discretionary powers to manage the assets on behalf of those investing in the CIV.18 This view is consistent with the fact that the investor’s tax situation is substantially different than it would be if he or she owned the CIV’s assets directly; these ownership differences demonstrate that the CIV, rather than the investor, is the beneficial owner of the income. The gain (net appreciation in value) received by investors who redeem their shares before income is distributed, for example, is taxed as capital gain rather than as ordinary income even if the appreciation in value is attributable entirely to dividends or interest income earned by the CIV.

The different ways in which CIVs satisfy (or not) these three treaty entitlement requirements provide ample support for including in treaties specific CIV-related provisions to ensure that investors receive, either directly or indirectly, the treaty relief to which they are entitled. Thus, even if a CIV does not satisfy the “person” test (because, for example, it is transparent), a treaty should still provide “practical and reliable procedures” by which the CIV could claim treaty relief for its investors. Providing a mechanism by which the CIV can act on behalf of its investors in this situation is especially important since no single CIV investor will have sufficient economic interest—given the small amount at issue and the expensive administrative procedure—to file a claim individually.

The CIV Report Recommendations

Because CIVs have different characteristics, the CIV Report effectively provides four different approaches to treaty relief. The approach that is most appropriate for domestic market CIVs is full treaty relief. CIVs that satisfy a publicly traded provision likewise should be eligible for full treaty relief. A third approach—for those CIVs that fail one or more of the person, resident, and beneficial owner requirements—is to provide proportionate relief based upon the treaty eligibility of the CIV’s investors. Under this third approach, the CIV could either claim proportionate relief on its own behalf or as an agent for its investors (depending, for example, on whether the CIV is treated as a person and resident). The final approach is to look through the CIV and provide relief based upon the tax status of its investors. Under this approach, a CIV held by retirement plans that would be exempt from withholding taxes could provide its investors with the same exemption that they would receive if investing directly.

17 Ibid. para. 31.

18 Ibid. para. 35.
Of particular importance to domestic market CIVs (such as US funds), the CIV Report recommends that treaty partners agree on the specific types of CIVs that are treaty entitled as persons, residents, and the beneficial owners of their income. Some governments, for example, would limit such treaty entitlement to those CIVs that are sold only domestically and that distribute their income periodically. This agreement between the two countries could be reflected through a modified treaty or a memorandum of understanding.

The Commentary to the OECD Model includes a paragraph (6.27) that provides one mechanism by which CIVs can claim treaty relief in their own right. Under this paragraph, full treaty relief is provided so long as the percentage of eligible investors exceeds a specified threshold. Countries could limit these “eligible investors” to residents of the treaty partner or take a broader view and include residents of any country with which the source country provides equivalent treaty relief (so-called equivalent beneficiaries). The Commentary also notes, in paragraph 6.30, that it may be appropriate to assume that a CIV is owned by residents of the country in which it is established if the CIV has limited the distribution of its shares. A CIV may decide to distribute its shares only domestically if domestic tax rules (such as distribution requirements and withholding taxes) make its shares tax-inefficient for non-resident investors or if securities law restrictions discourage offerings to non-residents.

For countries that believe CIV treaty relief should be proportionate only, based upon the treaty eligibility of its investors, it is essential that the procedures for claiming relief for CIV investors be administrable. Under such procedures, the relevant testing dates for determining the percentage of eligible investors must be specified (e.g., annually, no more frequently than quarterly, etc.) so that they can be built into automatic data collection systems of the CIVs and the intermediaries through which the CIV shares are held.

**TRACE**

The OECD’s CIV work was followed by an initiative to develop a comprehensive and simplified regime for providing appropriate treaty relief to CIVs and their investors as well as others whose relief claims flow through a series of intermediaries. This project is known as TRACE—for Treaty Relief and Compliance Enhancement. One impetus for the TRACE project was a recognition that the costs of administering treaty relief systems is high for investors, their custodian bankers, and governments. Indeed, the costs can be so high, or the procedures so cumbersome, that investors often are effectively forced to forgo treaty benefits; this result has adverse effects for investors, for capital formation in the source country (as after-tax returns are diminished), and for residence countries that provide investors with credits against their domestic tax liabilities for the higher foreign taxes that they have incurred.

TRACE allows financial intermediaries, such as a custodian bank or a CIV, to claim treaty benefits at source on behalf of its customers (or investors). Similar to the Qualified Intermediary (QI) regime in the United States, TRACE provides a mechanism by which financial institutions (FIs) can claim treaty relief for third parties. FIs that satisfy a source country’s requirements to become an Authorized Intermediary (AI), agree to undertake certain customer due diligence procedures to ensure the

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customers are treaty entitled, perform specified reporting, and be subject to independent compliance reviews. Most FIs, because of the US FATCA regime and/or the OECD’s Common Reporting Standard (CRS), already have many of these procedures in place.

TRACE involves five key generally applicable components. First, the financial institution must be approved by the relevant source country to act as an AI. The AI also has the ability to take on primary withholding responsibilities and would remain liable for any under-withholding.

Second, customers would indicate their treaty status by providing a self-certification to the AI, rather than having to obtain a certificate of residence (COR) from a tax authority. Self-certifications alleviate the significant administrative burden on tax administrations of routinely issuing CORs. As FIs already are required to collect self-certifications under FATCA and/or the CRS, these self-certifications easily could be modified to include treaty eligibility certifications. This self-certification would be supported by the customer due diligence requirements of the AI, including the obligation to monitor for changes in circumstances.

Third, the AI would make treaty claims for its customers on a pooled basis. Specifically, the AI would provide the withholding agent with a “blended” withholding tax rate that reflects the potentially varying treaty or statutory withholding tax rates applicable to the income recipients. To protect the sensitive competitive nature of its customers’ identities from competitors, this information would not be provided to the withholding agent. The withholding agent would rely on the AI’s certification of the appropriate withholding tax. The AI would be liable for any underpayments.

Fourth, the AI would report to the source country, on a customer-specific basis, the payments made to its customers and the tax withheld with respect to those payments. The information to be reported would include details of the type of income received and information (including name, address, tax residence, and taxpayer identification number [TIN]) for each investor. The source country would then exchange the investor-specific information with the investor’s residence country. These verification procedures would protect both source countries (by ensuring that only eligible investors receive treaty relief) and residence countries (by ensuring access to information regarding cross-border investments).

Finally, the AI would be subject to an independent review of its compliance with all customer due diligence and reporting obligations.

Importantly for CIVs, TRACE also includes model Memoranda of Understanding (MOUs) by which treaty partners could agree how each potentially eligible CIV should be treated. These MOUs incorporate the various alternative approaches included in the CIV Report.

In any context in which a CIV is required to determine the treaty eligibility of its investors, self-certifications would be held by the CIV or the intermediary that performed the customer due diligence procedures. To determine the percentage of eligible CIV investors, the AI (e.g., a custodian bank) would collect certifications from the CIV (for the direct investors) and brokers (for the indirect
investors). The AI then would determine the applicable (potentially blended) withholding tax rate and claim relief on a pooled basis.

Wide adoption of TRACE, including at-source withholding, would provide CIVs with much-needed certainty. Specifically, by knowing the exact amount of withholding tax due, CIVs would include the correct amount of income in their net asset calculations and price their shares accordingly. Estimates of the amount of tax relief to be recovered no longer would be necessary. Moreover, CIVs no longer would incur the substantial costs of documenting treaty eligibility on a reclaim-by-reclaim basis, responding to repeated requests for additional information, and monitoring tax recoveries.

**BEPS Action 6**

CIV treaty eligibility also was addressed in the Final Report on Action 6 of the OECD’s Base Erosion and Profit Shifting (BEPS) initiative to address concerns regarding potential treaty abuses such as treaty shopping. Action 6, as explained below, arguably introduces new uncertainty into CIV treaty eligibility.20

Under Action 6, countries must adopt either a principal purpose test (PPT) or a limitation on benefits (LOB) clause (or both) as a minimum standard to satisfy their commitment to implement Action 6.21 Most countries have agreed to meet their Action 6 commitment by implementing the subjective PPT (rather than the more objective LOB).

The PPT test is described in Action 6 as designed to prevent treaty benefits from being granted if “it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose” of the treaty.22

The LOB test in Action 6 follows, with some modifications, the US Model Treaty. Treaty benefits are limited under this test to residents that are “qualified persons,” such as individuals, certain publicly listed entities, certain pension funds, and “other entities that meet certain ownership requirements.” The Final Report provides both “simplified” and “detailed” versions of possible LOB treaty provisions. For example, the simplified version of the publicly traded companies and entities provision would apply if “the principal class of a company’s shares are ‘regularly traded on one or more recognized stock exchanges.’” The more detailed version of this provision restricts the exchanges on which the shares can trade or requires that the company’s primary place of management and control be in the country in which it is resident.

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20 Final Action 6 Report, supra note 4.

21 Ibid.

22 Ibid. at 55.
CIVs Under Action 6’s PPT Rule

The PPT’s subjective nature raises tax certainty concerns that are important for CIVs calculating a daily net asset value. The Final Report includes two general observations regarding the PPT’s scope. First, the Final Report states that it should not be lightly assumed that obtaining a benefit under a tax treaty was one of the principal purposes of a transaction or arrangement. Second, the Final Report states that “where, however, an arrangement can only be reasonably explained by a benefit that arises under a treaty, it may be concluded that one of the principal purposes of that arrangement was to obtain the benefit.”

Examples included in the Final Report, including one involving a CIV, provide additional guidance regarding the PPT’s intended scope. Given the specificity of the CIV example (Example D) and the implications (or not) for factual variations, it is provided here in full:

Example D: RCo, a collective investment vehicle resident of State R, manages a diversified portfolio of investments in the international financial market. RCo currently holds 15 per cent of its portfolio in shares of companies resident of 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 per cent to 10 per cent. 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 State R, but a number of investors (the minority investors) are residents of States with which State S does not have 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 its investors. RCo annually distributes almost all of its income to its investors and pays taxes in State R on income not distributed during the year. In making its decision to invest in shares of companies resident of 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 PPT Limitation]. The intent of tax treaties is to provide benefits to encourage crossborder investment and, therefore, to determine whether or not paragraph 7 [the PPT Limitation] 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 treaty to RCo.

23 Ibid. at 57-58.

24 Ibid. at 58.

25 Ibid. at 60-61.
Because of the relatively limited scope of Example D, which was first included in a draft version of the Action 6 report,²⁶ and in response to questions issued by the OECD thereafter,²⁷ ICI Global recommended that CIVs generally be exempt, expressly or effectively, from any PPT.²⁸ This result could be accomplished by including a second example of more general applicability. Specifically, ICI Global recommended an example in which a majority of a CIV’s investors are resident in any country with which the source country provides treaty relief comparable to that provided to the treaty partner, and which retains, rather than distributes, its income (i.e., a roll up fund).

This recommendation effectively would have embedded into the PPT the equivalent beneficiary approach that is essential to providing appropriate treaty relief to globally distributed funds. The recommendation also recognized that investors in CIVs are taxed twice on any income for which treaty relief is denied—first when the CIV receives the income and again when the investors dispose of their CIV interests. This type of double taxation is precisely what treaties are designed to alleviate.

Importantly, CIVs are not designed for treaty shopping purposes. Like shareholders of publicly traded companies for which treaty relief is provided, CIV investors hold only small interests in widely held investment vehicles. CIV investors are not sophisticated tax planners; instead, they are investors generally of moderate means who are saving for long-term needs such as retirement. Globally distributed CIVs serve important objectives; tax manipulation is not one of them. Moreover, to the extent that CIVs receive treaty relief only in proportion to their treaty-eligible investors (as provided by various provisions in the CIV Report) or only if a specified threshold is reached, a PPT should be inapplicable.

Any concern about potentially abusive arrangements, in situations for which relief is provided without regard to the treaty eligibility of the CIV’s investors, should be addressed through an example that illustrates when a CIV would violate the PPT. The ICI Global letter noted that such factors could 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.

ICI Global also expressed concern about the unilateral application of the PPT rule by an individual country. ICI Global explained that a PPT should only be applied upon the agreement of both countries’ tax authorities. 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 requisite certainty. These mechanisms are necessary to shorten any period of uncertainty about how much foreign tax the CIV will owe on cross-border investments. Again, this is essential for CIVs that must value their assets and liabilities each day to price their CIV interests.

**CIVs Under Action 6's LOB Rule**

Action 6 addresses the possibility that a CIV would be expressly included as a qualified person under the LOB rule (Paragraph 2(f)). The footnote to this special provision on CIVs provides that it should be drafted (or omitted) based on how CIVs are treated in each treaty partner and references the CIV discussion in the Commentary on Article 1 of the OECD Model (that was added following adoption of the CIV Report).

The Final Report explains that an express LOB rule specifying that CIVs are qualified persons will frequently be needed since a CIV may not otherwise satisfy the qualified person definition (Paragraph 2 of the Entitlement to Benefits Article) or is not engaged in the conduct of a business (Paragraph 3 of the article). The reasons given in the Final Report for why a CIV may not satisfy either Paragraph 2 or 3 include

- the interests in the CIV are not publicly traded (even though the interests are widely distributed);
- the interests are held by residents of third states (i.e., globally distributed);
- the distributions made by the CIV are deductible payments (e.g., a dividends paid deduction); and
- the CIV is used for investment purpose rather than for the “active conduct of a business” within the meaning of paragraph 3.  

**IV. Treaty Entitlement vs. Treaty Relief**

While significant progress has been made clarifying treaty entitlement approaches for CIVs, significant hurdles remain to obtaining treaty relief. Even for opaque CIVs that should be treated as persons and residents, challenges remain.

Governmental concerns, which the CIV Report was designed to address, arise from two factors. First, all CIVs are subject to provisions that effectively eliminate meaningful CIV-level tax; these provisions, while necessary to put CIV investors in a tax position comparable to direct investors, give some the impression that the CIV should be disregarded. Second, because a CIV is owned entirely by its investors, each investor has a proportionate interest in the CIV’s income and assets; this feature, while essential to providing investors with their share of the CIV’s investments, also give some the impression that the CIV should be disregarded. CIV distributions of income earned, to some extent, further the

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30 *Ibid.* at 32.
view that the CIV should be disregarded and/or that any requirement to distribute prevents the CIV from being the beneficial owner of its income.

Even when governments agree that CIVs are treaty entitled, or can claim on their investors’ behalf, difficulties can arise in proving to a government’s satisfaction the extent to which the CIV’s investors are treaty entitled. For CIVs—whether transparent or opaque—that are treated by a source country as entitled to claim treaty relief only to the extent that their investors are treaty entitled, this proof issue always is critical. Even for opaque CIVs that are treaty entitled, and presumably need to satisfy only an LOB or PPT, proof issues can arise. A CIV’s intermediated structure, however, can make proof issues difficult as the investor information often is held by the financial institution holding shares for its customers in a nominee account with the CIV. Getting timely access to this information can be costly and may exceed the amount of the tax relief on a single dividend.

The BEPS Action 6 Final Report arguably adds to the uncertainty—except perhaps for a domestically distributed CIV that clearly is covered by Example D. First, the example suggests that a CIV may not satisfy the PPT unless at least a substantial portion of its investors are treaty entitled. Second, the test is sufficiently subjective that bank custodians and withholding agents may well be unwilling to claim treaty relief for their CIV clients without some clear guidance from the source country regarding how it applies the PPT to CIVs.

V. Proposals

A clear path exists for ensuring that CIV investors receive appropriate treaty relief. First, governments must clarify, through published guidance or agreements with treaty partners, how they apply treaty eligibility provisions to CIVs. Second, governments must improve the procedures for receiving treaty benefits—preferably through implementation of consistent rules. Third, governments that adopt a PPT must clarify its application to CIVs.

*Adopt the CIV Report by applying its recommendations, in some manner, to all CIVs*

The simplest way for a country to clarify CIV treaty eligibility is to apply the CIV Report and issue guidance on which CIVs, their custodian banks, and other third parties and withholding agents can rely. The CIV Report provides numerous options for different factual situations; these options share the goal of ensuring appropriate treaty relief for all CIV investors through administrable mechanisms. This guidance can be issued through official circulars, through country-specific memoranda of understanding, or through treaty updates. Treaty updates should be the guidance route of last resort as they are likely to take the longest to implement.

CIVs that are opaque, domestically sold, and make current (annual) distributions of their income to investors do not present any of the governmental concerns discussed above. Such CIVs should be expressly identified by treaty partners as treaty eligible and as satisfying the applicable minimum standard (LOB or PPT) of Action 6. CIVs that do not share all of these features nevertheless need mechanisms, as provided in the CIV Report, to claim relief either fully or proportionately for their investors.
Practical and reliable procedures must be available for all CIVs to claim treaty benefits either in their own right or on behalf of investors.

*Improve Treaty Relief Procedures and Implement TRACE*

Governments should adopt the TRACE implementation package; the broader TRACE’s adoption, the greater the standardization of procedures and the lower the costs for investors.

TRACE provides governments with all of the assurances they need that treaty relief is being provided only to eligible investors. The rigorous requirements mandated by the CRS provide further comfort.

Moreover, as TRACE is entirely voluntary, financial services firms and industries have no reason to oppose its adoption. Those financial institutions that find the benefits to their clients outweigh the costs of becoming AIs, and thereby wish to gain access to TRACE’s many benefits (including at source relief), should be allowed to do so.

At-source treaty relief benefits investors and governments. By reducing substantially the need to file tax treaty reclaims, tax certainty for CIVs is enhanced. Governments benefit from lower tax administration costs and protection from two or more parties claiming treaty relief on the same income item (as has happened with the *cum ex* deals).

*Clarify Scope of PPT*

Clear guidance that CIVs do not raise PPT concerns must be provided. Any additional guidance from the OECD would be welcome. The most important guidance, however, will come from the source countries as they are the only ones that can provide withholding agents with certainty that treaty claims will not be challenged on PPT grounds. Without clear guidance, global custodians may well be reluctant to claim at-source relief in any country that adopts the PPT Rules—as the global custodian would be primarily liable for potential under-withholding should a country decide that a CIV had a “bad” principle purpose.

VI. Conclusion

CIVs make substantial capital—approximately US$50 trillion—available for economic growth. To maximize the efficiency of this capital, it is important that CIV investors receive the treaty benefits that their resident country tax authorities have negotiated with source countries. CIVs need clarity regarding treaty eligibility and treaty relief procedures that are administrable. Governments need solutions that are reliable. The CIV Report, TRACE, and properly applied BEPS Action 6 minimum standards meet investors’ and governments’ needs.