THE
INVESTMENT
ASSOCIATION
INVESTMENT MATTERS

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Dear Ms de Ruiter

RE: OECD DISCUSSION DRAFT ON BEPS ACTION 6

The Investment Association[1] welcomes the opportunity to comment on the BEPS Action 6 follow up consultation. We are grateful to the OECD for recognising the particular concerns of the funds industry in this follow up consultation.

We have been strong supporters of the work that the OECD has previously carried out in relation to treaty entitlement of funds, and BEPS affords a valuable opportunity to re-examine the issues that funds face in claiming treaty benefits nearly five years since the OECD report on The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles (the '2010 Report').

The ability of funds to claim treaty benefits is essential in ensuring that investors in funds are not disadvantaged in comparison to direct owners of securities. Funds are an essential savings vehicle, particularly for smaller savers and investors that otherwise lack the scale for cost effective access to the capital markets. All of this is recognised by the OECD in the 2010 Report. The importance of funds as a vehicle for long term saving is all the more relevant today, when citizens are increasingly being called to make their own provision for retirement.

Over $30 trillion of net assets are held by CIVs globally[2]. This represents over 40% of Gross World Product[3]. At least 39% of the world's equity CIVs invest cross border and for UK CIVs the figure is closer to 50%. CIVs are a vital instrument of choice throughout the world for many pension funds and smaller private savers.

[1] The Investment Association (formerly the Investment Management Association) represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of around $5.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

[2] International Investment Funds Association International Data Exchange – 2013: Q4

[3] CIA World Factbook estimate for 2013 (https://www.cia.gov/library/publications/the-world-factbook/geos/xx.html)

CIVs represent a key source of investment capital, and the ability of CIVs to access the protection afforded to investors by double tax treaties is vital to ensuring that capital invested through CIVs is available for cross border investment and the long-term financing of economies.

We recognise the importance of combating treaty abuse and treaty shopping, and we also support the broader objectives of the BEPS Action Plan.

In summary:

1. We believe that all the recommendations of the 2010 Report remain valid and relevant.

2. We believe that it is not necessary to change the overall findings or recommendations of the 2010 Report. However, it would be beneficial to reinforce some of the points that have presented greatest difficulties for funds in the recent past, and enhance some of the recommendations on application of LOB clauses. These are detailed below.

3. Practical experience suggests that some countries are not following the recommendations of the 2010 Report in the implementation of treaties. The 2010 Report has not resulted in greater certainty for CIVs and CIVs have found it increasingly difficult to access treaty benefits since its publication.

4. Governments should be encouraged to agree specifically on the treatment of CIVs in treaty negotiations, and agree on specific procedures and documentation necessary to claim treaty benefits.

5. The distinction between CIV and non-CIV funds should be made clearer, and policy differences should be informed by factors relevant to claiming treaty benefits.

6. A LOB approach to treaty entitlement presents significant problems for CIV funds, as has been widely discussed. However it may be a beneficial approach for non-CIV funds that are not widely held.

Our detailed comments on the questions relevant to CIVs are as follows.

Comments are invited as to whether the recommendations of the 2010 CIV Report continue to be adequate for widely-held CIVs and whether any improvements should be made to the conclusions included in that Report. Comments are invited, for example, on whether it would be advisable to provide for a preferred approach with respect to issues related to the tax treaty entitlement of the income of CIVs and the application of the LOB to CIVs, and if yes, on what that approach should be.

We believe that the findings and recommendations of the 2010 Report are good, and remain as relevant today as they were in 2010, and probably more so.

However, one of the objectives of the 2010 Report was to reduce uncertainty when dealing with funds claiming treaty benefits and to encourage governments to provide clarification on whether funds are entitled to treaty benefits in bilateral treaty negotiations. This objective is also highlighted in the BEPS Action 6 deliverable, in relation to policy considerations that countries should consider before deciding to enter into a tax treaty. In 15.5 of the new Section C says one of the considerations should be "the greater certainty of treatment for taxpayers who are entitled to benefit from the treaty".

The experience of the last five years suggest that this objective has not been met, and in fact the opposite has happened. Funds are encountering increasing administrative and legal obstacles in accessing treaty benefits, and uncertainty over treaty access for funds is widespread.

<u>General approach to treaty entitlement for CIVs</u>

Notwithstanding the above, we do not believe that an overarching single approach to treaty entitlement of funds is feasible or currently desirable, for the same reasons as highlighted in the 2010 Report - there are too many different fund structures, and no single approach could work to preserve the intended treaty treatment for investors in all funds.

However more work is needed to persuade governments that uncertainty around the treatment of CIVs is harmful to savers and should be dealt with in treaty negotiations. In particular with reference to the following factors:

- Funds that are corporates, or treated as corporates for tax purposes in their country of establishment **should be regarded as persons** under tax treaties.

- The viability of CIVs depends on there being only a single level of tax at either investor level or at fund level. The vast majority of CIV tax regimes provide exemption from tax at the fund level (either explicitly, or in practice by providing broad exemptions from tax on types of income). An exemption from tax is an indispensable feature of CIVs. **An exemption from tax should not in itself preclude a fund from being regarded as resident for tax purposes**.

- In determining whether funds **are the beneficial owners of income** under double tax treaties, countries should have regard to the above points, together with other features of funds, such as being widely held, that their investors have no control over the assets of the funds, and their assets are ultimately managed by an external investment managers.

Although each of these points is already made in the 2010 Report (and more subtly in the Commentary to the MTC), the practical experience of claiming treaty benefits for funds has deteriorated, and not improved. Therefore it would be beneficial to strengthen guidance to countries negotiating treaties to reinforce the point that funds can, and in most cases should, be eligible to treaty benefits in their own right and without reference to who the underlying investors are (subject to the existence of an LOB clause – see below).

Approved list of entity types

It would be helpful to reinforce the benefits of providing certainty in relation to specific fund vehicle-types, as is highlighted in the Commentary on Article 1 at 6.17. We believe that governments should be persuaded to prioritise clarification of CIV treatment in treaty negotiations. For example, countries could clarify that CIVs that take a certain legal form, or that CIVs that have a certain regulatory status (eg. A UCITS authorised CIV) should be eligible for treaty benefits. It is our members' experience that absence of specific clarification often leads to uncertainty and confusion.

It would also be helpful for the Commentary to clarify that countries should only seek documentation in support of a treaty claim that is relevant to that treaty claim.

For example, unless a treaty contains an LOB condition, there should be no reason why a country should need to establish treaty entitlement of a CIV by reference to the underlying investor if the conditions listed above are met. Therefore a tax administration should not request confirmation or certification of the status of underlying investors in a CIV unless that is specified as a requirement under the treaty.

A further example: a UK treaty might provide treaty benefits to Authorised Investment Funds that are incorporated as Open-Ended Investment Companies or Authorised Unit Trusts. Authorised Investment Funds are widely held and subject to investor protection regulation. The vast majority are authorised to be sold to retail investors in the UK, either under the EU UCITS Directive, or otherwise as Non-UCITS Retail Schemes. However UK funds are frequently asked to provide evidence of UCITS status, even where UCITS status is irrelevant under the particular treaty, because the treaty provides benefits to all Authorised Funds. This is an important point because it will be different government agencies that are able to provide certifications of status. For example, HM Revenue & Customs can certify that a fund is a UK Authorised Investment Fund, but cannot certify that a fund is UCITS compliant – this falls to the Financial Conduct Authority. Only HM Revenue & Customs will routinely provide treaty documentation. Documentation being required of other agencies can lead to delays, or loss of treaty benefits.

Approach to limitation on benefits in the MTC

The 2010 Report presents three possibilities for countries in opting to apply anti-treaty shopping provisions in the form of an LOB clause:

[6.17]	A CIV is entitled to treaty benefits without reference to an LOB condition
[6.21]	A CIV is entitled to treaty benefits if a proportion of investors are themselves treaty eligible, or are equivalent beneficiaries
[6.26]	A CIV is entitled to treaty benefits if a proportion of investors are themselves eligible to the same treaty (no equivalent beneficiaries)
[6.28]	Treaty benefits are assigned to investors in a CIV (a look through basis).

For reasons that have been widely discussed elsewhere (including in 6.29 of the Commentary), CIVs face particular difficulties in meeting the conditions of an LOB clause. Interests in CIVs are widely held, rand their interests are often held through intermediaries. CIVs do not know the beneficial owners of their interests and ae not able to access information regarding their respective residence status and/or treaty eligibility. (However, they are normally able to make informed assumptions treaty eligibility based on how the CIV is distributed – see section below on practical implementation of limitation on benefits).

The Action 6 Deliverable proposes that entities that are regularly traded on recognised stock exchanges should be regarded as qualifying persons under an LOB condition. As we understand it, the reasons for this are:

- frequent changes in ownership of listed entities mean that meeting an LOB condition is difficult because of the lack of information on residence of underlying owners; and
- listed and traded companies represent a low risk of being used for treaty shopping because shareholders are generally not able to exercise control over the company.

Both of these points are equally true of CIVs that are not regularly traded on a recognised stock exchange.

For these reasons, and for the reasons highlighted above to reinforce arguments on beneficial ownership and residence, we believe that the appropriate and proportionate approach is that a CIV should not have to meet an LOB condition.

One final point is that distinguishing between listed and non-listed CIVs could represent a significant and unwarranted commercial distortion between listed and non-listed vehicles. Such a distinction was deliberately avoided in the OECD's Common Reporting Standard on Automatic Exchange of Information because the OECD was persuaded that listed and non-listed CIVs could be substitutes in the hands of investors and therefore should be treated the same.

Notwithstanding the above, we recognise that certain countries may insist on including a LOB clause in their treaties.

CIVs are widely held and are often sold across borders. In the EU, the UCITS Directive provides a common regulatory framework for CIVs that are sold to retail investors, and it has established within the EU a working Single Market for CIVs. CIVs domiciled in one EU country are frequently and commonly sold to investors in other EU Member States. The consultation recognises that LOB without equivalent beneficiaries presents a legal problem within the EU. We would add that it presents an urgent practical problem to CIVs within the EU.

Outside the EU, the recently developed ASEAN CIS fund passport scheme, and the Hong Kong/China mutual fund recognition platform provide further examples of efforts made by governments to increase the availability of financial products to citizens, and facilitate cross border investment. Such schemes allow residents in one country to freely access investment in CIVs in another country. The LOB rule without an equivalent beneficiaries condition could present an impediment to the success of these schemes. We note that these mutual recognition regimes are not required by law (as in the case of the EU Treaty) but are government policies, but are no less meriting of special consideration with regards to application of the LOB rule.

6.26 of the Commentary notes that some countries might believe that including third country investors as equivalent beneficiaries violates the bilateral nature of treaties. Whilst this may be true, adopting this position presents problems, and will render treaties increasingly ineffective in the face of the globalisation of financial markets. Evidence that LOB without equivalent beneficiaries represents a barrier to cross border investment is given by the examples above related to CIVs.

6.28 of the Commentary outlines the alternative approach that countries might allow CIVs to make treaty claims on behalf of its investors. This should be the treatment that corresponds to CIV that are not persons under a tax treaty – in which case the CIV (or its agent) is simply acting as agent for the investor. However in cases where a CIV is a person, it is likely that the CIV takes corporate form (or a legal form that is treated as a corporate) in most cases. This creates the practical problem that a CIV might not be able to allocate treaty benefits to the specific eligible investors, when the interests of the CIV are fungible. Where treaty benefits are shared equally between all investors, this would create adverse selection and free rider problems.

In conclusion, our view is that any LOB clause needs to be accompanied by an equivalent beneficiaries condition that can be used by CIVs. Critically the LOB condition should not limit the number of possible equivalent beneficiaries because a cross border fund that is widely held could very easily have many such investors.

Practical implementation of limitation on benefits

We believe that the 2010 Report provides relevant and useful guidance on how a LOB clause should be applied in practice to CIVs (incorporated into the Commentary to Article 1 of the MTC at 6.30/31).

The Commentary at 6.30 explains that in many cases, CIVs will be overwhelmingly domestic. We think it is also true that, even where a CIV in distributed across borders, many distribution agreements will be overwhelmingly domestic – ie. targeting investors in a particular jurisdiction. So we believe that the Commentary at 6.30 could be expanded to a include similar conclusion in respect of distribution agreements – for example "it may be appropriate to assume that interests in a CIV are owned by residents of Country A if those interests are held in a nominee account of a distributor that distributes the CIV interests only in Country A, or where, for example, the distribution agreement provides that it will distribute only in Country A".

We believe it would be helpful to expand on the Commentary at 6.31 with examples of practical steps a CIV might take when distributed across borders. For example, we understand some advisers believe that a CIV needs to obtain investor self-certifications (or US W8-BEN forms) from underlying beneficial owners in order to satisfy the requirements to collect information. We believe it would be helpful for the Commentary to specify that a CIV may obtain simple confirmations of the proportion of aggregate accountholders from a particular jurisdiction and is not required to obtain investor-by-investor information of tax residence.

Comments are invited as to whether the preceding paragraphs accurately describe the treaty entitlement issues of sovereign wealth funds, pension funds and alternative funds / private equity funds. Comments are also invited as to how to address these issues without creating opportunities for treaty shopping.

Definition of CIV and non-CIV funds

The term CIV is limited to funds that are widely held, hold a diversified portfolio of securities and are subject to investor protection regulation in the country in which they are established (para. 4, 2010 Report).

We note that there are many funds that may not typically be thought of as CIVs that could meet this condition. For example, many hedge funds established in the Cayman Islands or other typical offshore locations could claim to meet these criteria, as could some private equity, property, debt funds or securitisation vehicles. We note that within the EU, the Alternative Investment Fund Manager Directive now provides investor protection regulation for all funds that are not UCITS.

If different criteria are to apply in treaty negotiations for CIVs and non-CIV funds (and we believe that this is justified in some cases – see below), we think it will be helpful to provide greater clarity on what it meant by the terms. We think that the distinction should be based on criteria that is relevant to the tax treatment and treaty entitlement. The key condition should be whether a fund is widely held (or more accurately whether a fund intends to be widely held and is marketed as such, even if it is not in practice). Other relevant and necessary conditions are that its investor have no control over the assets of the fund.

We do not see the reason for a distinct analysis in treaties of funds that offer different degrees of investor protection regulation, or of funds that have diversified assets, or that invest solely in securities (as opposed to, say, property). It is the case, however, that funds that have greater investor protection regulation are more likely to be funds that are offered to a greater variety and number of investors, and are therefore more likely to be widely held. So in many cases it will be appropriate to include regulated funds in a list of types of entity qualifying for treaty benefits.

Treatment of non-CIV funds

For funds that are not widely held some of the arguments made above about the treatment of CIVs will not apply. It cannot be said that a fund which is not widely held provides a means of accessing capital markets for smaller investors, and neither is it true in general that a fund that is not widely held cannot conceivably obtain information about its investors in order to meet an LOB condition.

However, funds that are not widely held do provide significant social benefits. Such funds provide vital source of capital to companies, particularly to small and medium businesses, and provide significant capital (often invested across borders) to infrastructure projects, property development and other economic activities. The exclusion of these funds from obtaining treaty benefits is a barrier to cross border capital, and a disincentive to invest, and could ultimately deprive businesses and governments of vital capital.

We see no reason why the analysis above under “General approach to treaty entitlement for CIVs” should not also apply to non-CIV funds except that where a fund is not widely held, it may be appropriate to determine its entitlement to treaty benefits by reference to the entitlement to treaty benefits (or equivalent benefits) of its underlying investors. In this case an LOB (with equivalent beneficiaries) might be an optimal approach. This is because a relatively small numbers of investors and low investor turnover make it feasible to comply with an LOB. It would also ensure that a limited number of large institutional investors are not disincentivised from pooling investment in a fund to make capital available to markets because they would have a worse treaty outcome than if they invested directly.

Commentators are invited to suggest additional examples that could be included in paragraph 14 of the Commentary on the PPT rule (paragraph 17 of the Report). For example, representatives of investment funds are invited to suggest an additional example that would deal with the non-tax motivated use of a special purpose vehicle in order to pool the investment of various institutional investors from different countries.

PPT rebuttable presumption

We concur with the comments made by ICI Global that the example given on p.72 of the Deliverables report is an excellent starting point, but that it would be helpful to include further examples of funds that are non-distributing and that are majority owned by investors that are equivalent beneficiaries, rather than treaty beneficiaries.

We believe that these two modifications in the example serve well to deal with the position of non-CIV funds. For example a special purpose vehicle resident in Country R manages a portfolio of properties in Country S. Under the tax convention between R and S the withholding tax rate on dividends is reduced from 30% to 10%. RCo's investors are resident in countries A, B and C, each of which has a tax treaty with Country S. In each case the treaty reduces the withholding tax to 10%, except in the case of the tax treaty between Country S and Country C, in which the withholding tax rate is 15%. RCo has no specified distribution policy. In most cases income is not expected to arise, but where it does, it may be retained by RCo for further investment or development. Otherwise the same facts exist as in example D, and the same outcome should arise.

We note that if in the above example, countries A, B and C had no treaty with Country S, and in incorporating RCo, Country R was deliberately chosen so that investors could obtain the benefits of the R-S treaty, this may serve as a useful example where a PPT might be invoked.

Finally, I would like to thank for the opportunity to comment on the discussion draft and we appreciate the considerable efforts that have been made to consider factors that are uniquely relevant to the funds industry. We hope to be able to continue to contribute to the consultation and I am available at your convenience to discuss anything in this letter at jorge.morley-smith@theinvestmentassociation.org or on +44 (0)20 7831 0898.

Yours sincerely

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cc. Mike Williams — HM Treasury
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