Irish Funds
10th Floor, One George's Quay Plaza,
George's Quay, Dublin 2, Ireland.

t: +353 (0) 1 **675 3200**
f: +353 (0) 1 **675 3210**

e: **info**@irishfunds.ie
w: **irishfunds**.ie

BY EMAIL:

Tax Treaties
Transfer Pricing and Financial Transactions Division
OECD
OECD Headquarters
2 rue André Pascal
75116 Paris
France

22 April 2016

Dear Madam/Sir,

Re: Public Consultation on Treaty Entitlement of Non-CIV Funds

We are writing to you in response to your public discussion draft on the treaty entitlement of non-CIV funds dated 24 March 2016 (the "**Discussion Document**").

The Irish Funds Industry Association ("**Irish Funds**") is the representative body of the international investment funds community in Ireland, representing the administrators, depositaries, managers, transfer agents, fund promoters and professional advisory firms involved in the international fund services industry in Ireland. Ireland is a leading centre for the domiciling and administration of collective investment vehicles, with industry companies providing services to collective investment vehicles with assets totalling in excess of €3.8 trillion.

Irish Funds acknowledges the good work that has been done to date in respect of Action 6 of the OECD's Base Erosion and Profit Shifting project ("**BEPS**"), and welcomes the opportunity to discuss its application to non-CIV funds in more detail.

1 General comments

1.1 Economic importance of non-CIVs

We agree with the OECD that non-CIV funds are economically important to the global economy and that non-CIV funds should therefore be granted treaty benefits in appropriate cases. The development of cross-border investment in the 'real' economy, i.e. in infrastructure, technology, sustainable energy and unlisted companies, is a policy objective of the EU's Capital Markets Union ("**CMU**") initiative and similarly, of the OECD and governments globally. Non-CIV funds are typically deployed for such investments, as restrictions often relating to CIV type funds would prevent them investing in such asset classes (e.g. eligible asset restrictions, diversification requirements, liquidity etc.).

In this regard, it is critical that the important role non-CIV funds play in the real economy is recognised. With net assets totalling €452 billion, Irish regulated cross-border AIFs are a key feature of this

important investment landscape and the treaty entitlement of regulated non-CIV funds is a key issue for globally distributed, regulated investment funds. We appreciate the concerns raised in respect of the treaty entitlements of non-CIVs and are eager to ensure that non-CIVs are not used inappropriately for the purposes of treaty shopping.

1.2 Background on Irish collective investment schemes

By way of background, our responses to the questions are answered in the context of regulated funds. Irish collective investment schemes are subject to EU and local regulation with a focus on governance, organisational and operational arrangements, product specific requirements, transparency and investor protection. Irish collective investment schemes, established as either UCITS or AIFs, are authorised and subject to ongoing supervision by the Central Bank of Ireland. Irish funds are distributed globally in over seventy countries and also invest globally in a diverse range of assets classes. As such, our response is from the perspective of the regulated cross-border funds industry in its role in facilitating important cross border investment.

Irish collective investment schemes operate in a clear, certain and transparent tax environment and are subject to the highest standards of automatic exchange of information under the Common Reporting Standard and FATCA.

1.3 Opportunity for further engagement

We note that commentary of the OECD in the Discussion Document does not yet represent a proposed consensus approach nor does it set out proposed steps for dealing with the treaty entitlement of non-CIV funds. We therefore would welcome the opportunity to further engage with the OECD in the context of any emerging consensus or proposals arising from the consultation.

We have the following comments and observations on the Discussion Document.

2 Concerns related to the LOB provision

Treaty access for regulated and/or widely-held non-CIV funds.

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

We believe that it would be very challenging to definitively define what '*widely held*' means in an investment fund context. Investment funds are established in a wide variety of ways, depending on the circumstances catering for different types of investors and often involving different types of feeder funds and intermediaries for various commercial reasons. We believe that the absence of a description of this term in the 2010 OECD report on the granting of treaty benefits with respect to the income of collective investment vehicles (the "**2010 Report**") was intentional, and reflected the challenges that would be involved in determining and agreeing what 'widely held' means.

In any exercise to determine a threshold for the term 'widely held', it would be important to recognise that non-CIV funds may be indirectly widely-held. For example:

a) A non-CIV may have one direct investor, holding 100% of the units in that non-CIV. However, that single direct investor may be acting as a feeder fund for a large number of unconnected

third party investors. If that feeder fund is ‘widely held’, then the underlying non-CIV should also be treated as ‘widely held’, even though it only has one single direct investor.

b) A non-CIV may have one direct investor, but that investor may itself have characteristics that result in the non-CIV being ‘widely-held’. In particular, if that single direct investor was a pension fund, which had a large number of unconnected beneficiaries, then the non-CIV should be treated as ‘widely held’, even though it only has one direct investor.

In addition, it would be important to recognise the position of non-CIVs where they have launched and are in a growth phase. We believe that it would not be appropriate to penalise such non-CIVs simply by reason of any predetermined threshold not being met.

To the extent that it is decided to provide more description on what ‘widely-held’ means, we believe that it may be more fruitful to approach this from the other perspective, and describe funds which it is agreed are *not* ‘widely held’. This may be more in keeping with the true intention of the 2010 Report.

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

We would note that the regulatory requirements listed in paragraph 12 of the 2010 Report are simply examples of regulatory restrictions that may be imposed on regulated funds. They are not essential or prerequisite restrictions to which a CIV must be subject before it can be considered to be sufficiently ‘regulated’ for these purposes. This is clear from the preamble of the sentence, which commences “*Typically*, there will be …” (our emphasis). This is also clear from the earlier definition of CIV in the 2010 Report as a fund which is “subject to investor-protection regulation”, which is notably a broader description.

In our view, if being ‘regulated’ or ‘subject to investor-protection regulation’ is a condition to more favourable treatment under an LOB, non-CIV funds should not have a higher regulatory threshold than CIV funds to access treaty benefits. If a particular regulatory regime meets the agreed threshold for CIV funds, it should equally meet any such threshold for non-CIV funds.

In addition, given that non-CIVs invest in a wider range of assets, the regulatory framework imposed on non-CIVs is typically different to that imposed on CIVs. We believe that certain of the following regulatory characteristics are typically seen in regulated non-CIVs. These should be considered if it is felt that it is necessary to list relevant characteristics:

- requirement for assets to be entrusted to a single, independent, **regulated depositary, custodian or trustee**;
- requirement for the investment manager to be a **regulated investment manager**;
- requirement for an independent **regulated administrator**;

- requirements on full **disclosure** to investors of investment policy, risks and conditions;
- requirement for **fair treatment** of all investors in the non-CIV;
- restrictions on **related party investments**;
- rules on **valuation** of the non-CIV's assets; and
- approval of **board members** of the non-CIV by the regulator of the non-CIV.

Finally, we would note that many regulated non-CIVs will also have, in the normal course, feeder funds through which investors make their investment, and these feeder funds may not themselves be regulated funds.

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

If a non-CIV is both widely-held and regulated, then the only difference between it and a CIV (in line with the description of CIVs in the 2010 Report) is the type of assets in which it invests. A CIV must invest in a 'diversified portfolio of securities', whereas a non-CIV in this context would be investing in another asset class (e.g. commodities, infrastructure).

We do not see any reason why the type of assets held by a fund should influence whether it is entitled to treaty access or not. For example, it should not matter for treaty access whether a fund invests in stocks and shares or, alternatively, commodities. The policy rationale for granting treaty access should be the same either way.

The 2010 Report agrees that a CIV should be entitled to treaty access. In our view, a non-CIV which is both widely-held and regulated (and only fails to qualify as a CIV because it invests in assets which are not 'securities') should equally be entitled to treaty access on its own merits. It is difficult to see any policy justification to deny treaty benefits to such non-CIVs.

While appreciating that this treaty-shopping concern has arisen, we believe that an explanation of how widely-held, regulated funds operate and the regulations and transparency requirements to which they are subject should properly address this concern. In particular, we disagree with the contention that it is 'relatively easy' for a widely-held, regulated fund to be used for treaty shopping The fact that the fund is widely-held (and managed by a regulated investment manager and subject to a comprehensive regulatory regime) is strong evidence that the fund has not been established for a treaty shopping purpose. In addition, it is important to note that there are many reasons why investors may choose to invest in non-CIV funds, including:

- the improved security for their investment, provided by a regulated fund regime;
- reduced investment costs by reason of collective investment;
- access to expertise in investment portfolio management; and

- ongoing oversight of investments.

These are the main reasons for investing in regulated non-CIVs. For this reason, we would respond that a non-CIV which is both widely-held and regulated should be treated in the same way as a CIV in the application of the LOB.

The treaty-shopping concerns are addressed because the fund is ‘widely held and regulated’. Such funds are established for normal commercial reasons, and not to ‘shop’ for a favourable tax treaty, as was accepted to be the correct position by the 2010 Report.

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

In our view, a mandatory distribution requirement should not be imposed as a condition of any treaty access. No such distribution requirement is proposed for CIVs, even though they also can result in the ‘deferral of tax’ for investors in CIVs which do not regularly make distributions. As the context of this question deals with non-CIVs which are regulated and widely-held, we do not see any policy rationale for requiring widely-held, regulated non-CIVs to make periodic distributions, when it is agreed that CIVs are not expected to do similar.

Additionally, our experience is that the question of whether a fund will be established on the basis that it will make periodic distributions is driven by commercial considerations, and not tax considerations. We would also note that there can sometimes be restrictions on distributions imposed by law, if the relevant entities do not have sufficient reserves to legally pay the distributions.

Therefore, for widely-held, regulated non-CIVs, we do not believe that there would be real concerns shared by a majority of member states about deferral of tax. Widely-held, regulated non-CIVs are established for bona fide commercial reasons, and not for the avoidance (or deferral) of tax. This was accepted by the 2010 Report in the context of analysis of CIVs, and should equally be accepted here.

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

Publicly-listed companies are entitled to treaty access under an LOB provided, broadly, their shares are sufficiently “regularly traded” on a recognised stock exchange in their country of residence (or other specified exchange, subject to further conditions).

The “regularly traded” condition for publicly-listed companies is the equivalent of the “widely held” condition for funds. Indeed, the 2015 Final Report on Action 6 (the “**2015 Report**”) explains the special treatment of publicly-listed companies by stating that “shares of publicly traded companies … are generally widely-held … [and] are unlikely to be established for treaty shopping” (our emphasis).

For the same reason, regulated funds which are widely-held are equally unlikely to be established for treaty shopping. In other words, the widely-held nature of both these types of entities makes them justifiably entitled to different treatment under the LOB (when compared with normal companies and corporations).

Therefore, we believe there are strong policy reasons for granting an exception to widely-held, regulated investment funds - whether CIVs or non-CIVs - which is equivalent to that granted to publicly-listed companies. We would suggest that it is difficult to see a policy reason to reach a different conclusion.

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

There are no typical approaches to 'investing through intermediaries'. The majority of regulated non-CIVs, in our experience, make their investments directly (and not through intermediaries). When investments are made through intermediaries, the approach taken will depend on the asset class involved. For example, where non-CIVs make investments in real estate, it can be the case that such investments are made through wholly-owned subsidiary companies established in the State of source.

We would note that the use of intermediaries for holding assets is typically driven by commercial concerns, rather than tax. The nature of the assets in question (e.g. real estate, infrastructure, energy) means that there are commercial factors such as senior debt/project finance, minority owners or co-owners, contractual relationships with customers/tenants/suppliers etc. Some or all of these factors will generally trigger a requirement for intermediate holding companies to hold all or part of the assets of the non-CIV.

Non-CIV funds set up as transparent entities

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

The new transparent entity provision will be, we believe, an important tool to ensure that source countries correctly recognise the tax transparency of fiscally transparent entities, and grant treaty entitlements by reference to the tax treaty between the investors' countries of residence and the source country.

In addition, we believe that the implementation of TRACE, or a workable alternative, remains very important to the successful granting of treaty benefits to tax-transparent non-CIVs. This is particularly so for widely-held fiscally transparent CIVs and non-CIVs. In the absence of a full global

implementation of TRACE, there will always and inevitably be large segments of tax-transparent CIVs and non-CIVs which will find it challenging to claim treaty benefits on behalf of their investors.

Derivative benefit rule applicable to certain non-CIV funds

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

In our view, this example supports the inclusion of a derivative benefits clause which caters for funds in the LOB, and is an important example to show why such a derivative benefits clause is necessary to ensure treaty access is not unfairly denied.

However, we would not support the restriction of any such derivative benefits clause to 'institutional investors'. In our view, the rationale for a derivative benefits clause is a good one, irrespective of the commercial/regulatory/financial status of the investors.

Whilst we believe it would be very challenging to define an exhaustive list of all types of 'institutional investor', we believe it would include at the very least banks, other regulated funds, pension funds, insurance companies, charitable endowments, sovereign wealth funds and governments. However, we would note that, where those institutional investors make their investments through intermediate entities, the identification of the 'institutional investors' becomes more challenging.

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

We believe there may be a simple way to deal with this definitional issue.

The proposed derivative benefits rule should be included in the LOB, because the 'seven or fewer' test in the main derivative benefits rule will not work for non-CIVs (which will typically have much more than seven investors). We would also note, in passing, that in the context of investment funds the focus on a small number (seven or fewer investors) runs contrary to investment funds being 'widely-held' in the first place.

However, we can see no reason why this additional derivative benefits rule should not be applicable to all companies (and other persons that are not individuals, such as unit trusts). In other words, any company – whether a collective investment vehicle or not – should be able to benefit from its terms. If an 80% equivalent beneficiary threshold is imposed, what concerns could member states have, if a company that was not an investment fund nevertheless satisfied the factual conditions imposed by the rule and sought to claim treaty benefits as a result?

This approach would mean that there would be no requirement to define what is a 'non-CIV'. We believe there is much merit in adopting this approach.

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

We would not support the inclusion of any specific anti-avoidance rules.

The whole rationale for employing an LOB to prevent treaty shopping is that it provides a clear test for determining treaty access, and thus provides certainty for taxpayers. Whilst an LOB can deny treaty benefits to persons who arguably should not be denied, the quid pro quo is that – where the LOB is satisfied – treaty access should generally be guaranteed (subject to satisfying the OECD-approved domestic anti-conduit rules).

There are no such 'anti-avoidance' rules proposed for the standard clause (e) of the LOB (ownership / base erosion). It must be remembered that clause (e) will permit treaty access even where 49% of the shares of the company are held by persons who are not entitled to similar or better treaty benefits. If no anti-avoidance rule is considered justifiable in such instance, we do not see the rationale for imposing such anti-avoidance rules for this derivative benefits rule.

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

We would not support the introduction of this condition. We believe that a derivative benefits rule for non-CIV funds should operate without this condition. This rule should operate, like the remainder of the LOB, as a clear mechanical test and, if no such condition is imposed for clause (e) of the LOB, we do not see a justification for such an imposition under this proposed derivative benefits rule.

That said, we believe that the appointment of a regulated investment manager by a non-CIV would be a good indication of a bona fide investment objective.

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

We would not support the introduction of this condition, for the same reasons as outlined in our response to question 11.

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

It is not possible to generalise. Some non-CIV funds have very dynamic changes in ownership, especially where they are widely-held and regulated, but are investing in alternative assets. Other non-CIV funds have relatively stable ownership over their life. A material factor which tends to influence this matter is the type of assets in the non-CIV. For example, a non-CIV which invests in frequently traded commodities tends to be more liquid in its investment assets, and may have a more dynamic change in its investor base. In contrast, a non-CIV making long-term investments in infrastructural assets should tend to have a more stable investor base. This is no different to CIV funds which are closed-ended in nature, and as a result tend to have stable and static ownership over their life.

Question 14. How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners

are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

We would agree that this proposal does not address such concern. For this reason, we believe that widely-held, regulated non-CIVs should be treated in the same way as CIVs for the purposes of the LOB, so that they could obtain treaty access in their own name. Our answer to question 3 above sets out our case in this regard.

For non-CIVs that are not widely held and regulated, and may need to rely on a derivative benefits rule, there is a challenge in determining the identity of the ultimate beneficial owners. TRACE would offer the best solution. In the absence of full implementation of TRACE, it may be possible to operate an adapted version of TRACE, using self-certification by investors through intermediaries, to the non-CIV to offer a practical mechanism for the collection (and submission) of the relevant information. A self-certification approach has been successfully implemented in recent years by FATCA, and by the OECD in respect of the Common Reporting Standard.

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

It varies, depending on a non-CIV's ownership structure. In some cases, the managers and administrators of non-CIV funds will have full knowledge of the ultimate beneficial owners. This is especially the case where such owners invest directly in the non-CIV. However, in other cases, the managers and administrators will have no information at all regarding the ultimate beneficial owners. In particular, where such investors make their investment through a financial institution (eg, a bank or stock broker), the non-CIV (and its manager and administrator) will only have to look to that financial institution named on the share register when carrying out their AML, FATCA and CRS due diligence procedures. There are clear rules under AML, FATCA and CRS in this regard, setting out the circumstances when a non-CIV is required to look only to the financial institution recorded in the share register of the non-CIV as the holder of the shares. As a result, in many cases, the non-CIV is not required (for AML, FATCA or CRS) to look beyond such intermediary, and does not have any legal entitlement or authority to do so. Of course, that intermediary will generally have its own AML, FATCA and CRS due diligence procedures to carry out on the persons for whom it holds the units in the non-CIV.

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

Yes, intermediate ownership does present real obstacles to obtaining the relevant information. In our view, TRACE offers the best solution to this issue.

However, we would reiterate our view that widely-held, regulated non-CIVs should be entitled to treaty benefits in their own right.

For other non-CIVs, and in the absence of full implementation of TRACE, it may be possible to introduce an adapted version – through a self-certification model – under which investors confirm their status to the intermediary with whom they deal, and this information is passed to the non-CIV, similar to the approach adopted and accepted for FATCA and CRS purposes and US treaty entitlement forms such as the W-8BEN form.

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

We disagree with the statement that typical CIVs do not tend to have chains of intermediaries. In our experience, a sizeable proportion of CIVs do have chains of intermediaries. These intermediaries are generally financial institutions, such as banks and stock brokers, who hold the units in the CIVs on behalf of the ultimate beneficial owner. In this regard, we would refer to the 2010 Report where it is stated that "in almost all markets, direct purchases (and holdings) are a small proportion of the investments in the CIV. Much more common are indirect share purchases through one or more intermediaries."

However, we agree that for many non-CIV funds it will be challenging in the current administrative environment to obtain the necessary investor confirmations. In the absence of full implementation of TRACE, we would propose that an adapted self-certification model, as described in our response to question 6 may be a suitable approach for non-CIVs that are not widely held and regulated.

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

A company seeking to satisfy the LOB under clause (e) (ownership / base erosion) will satisfy the LOB even if investors not entitled to similar or better benefits hold a 49% participation of its shares. If such a 49% participation is acceptable for a company in normal cases, we believe there should be no concern over granting a 20% participation threshold for non-CIVs under the derivative benefits test. Such non-CIVs are clearly not established for treaty shopping purposes. Put another way, the 80% of the investors in that non-CIV are not making their investment to facilitate treaty-shopping by a small minority of investors.

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

If a 50% base erosion test is acceptable for all other types of companies under the LOB, we cannot see any policy justification for imposing a higher threshold for non-CIVs. Put another way, before applying a base erosion test:

- under this derivative benefits proposal, a non-CIV would be granted treaty access if 80% of its investors were entitled to similar or better treaty benefits; and
- under the normal clause (e) test (ownership / base erosion), a company would be granted treaty access if 50% of its investors were entitled to similar treaty benefits (by being resident in the same country as the company itself).

The starting point is therefore that non-CIVs must have a significantly higher threshold of 'equivalent beneficiaries' to reach, and therefore the 'room for treaty shopping' (to use the OECD phrase) is already substantially less than for a normal company.

Therefore, we cannot see a logical rationale for imposing a higher base erosion threshold on non-CIVs than for normal companies. Such a move would only further tilt the environment unjustly against non-CIVs.

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

We disagree with the contention that deferral concerns should result in a denial of treaty benefits for investment funds, whether non-CIVs or otherwise. We believe this may be a misguided concern, and fails to appreciate the nature of financial investment.

Firstly, the 2010 Report accepts that CIVs should be entitled to treaty benefits even if there is some deferral of the taxation of the profits in the hands of the investors in the CIV. This reflects the nature of investment funds, that they do typically accumulate investment returns for a period of time, before making distributions to investors. The reinvestment of profits is an intrinsic part of collective investment, and there are good commercial reasons why investment funds carry on their business in this way. Investors and, in particular, pension fund investors frequently seek out funds that do not distribute their profits each year, but instead reinvest their profits in fresh investments. This allows investors to make their investment decisions in line with their long term financial needs and timelines. In our experience, CIVs and regulated non-CIVs are not set-up for the purpose of achieving 'tax deferral'. They are instead set-up to achieve commercial objectives such as long term investment. The denial of treaty benefits in circumstances where investors are simply making bona fide commercial decisions to make long term investments would be a wholly disproportionate response to an issue which is in no way a driver or factor in the investment decisions made.

Second, aside from investment funds, tax treaties have never imposed an anti-deferral test for granting treaty benefits. Companies (aside from investment funds) are generally entitled to treaty benefits,

even if they will not be actually subject to tax on the item of income because of their specific circumstances, such as the availability of tax losses or tax depreciation, or a specific tax exemption under local law. This general principle has been accepted over the decades without question, and we believe that it should not be diluted in the context of investment funds (whether non-CIVs or otherwise) through the introduction of an anti-deferral regime.

Third, we would note that, even where there is a deferral of the return of profits to investors, the profits are always returned to investors in due course. In the current context of a derivative benefits clause, it will have been confirmed that the investors will be resident in countries with equivalent tax treaties, so the State of source should have comfort that the income in question will be appropriately taxed.

Fourth, any concern about deferral must also be tempered by the acknowledgement that investors are wholly open to making losses on their investments through the non-CIV. Investors must also suffer 'deferral' of their recognition of any losses as a natural result of the way investment funds operate. Investors accept this consequence of their investment decision.

Fifth, we would note that there are other OECD BEPS action items to address perceived abuses of 'hybrid mismatches' and non-taxation of income. We would submit that such action items are better placed to address any concerns from member states in this area.

Finally, countries may of course decide to introduce anti-deferral rules for their residents on a domestic basis. Many jurisdictions have indeed adopted rules in this regard for their residents, including Ireland. Many jurisdictions also impose a higher taxation regime for investment funds which provide for deferral. In other words, if investors are not taxed on a current basis on their investment in an investment fund, the investor is taxed at a higher rate when it earns its return from that investment fund.

Question 22: The proposal above was presented as a possible additional derivative benefits rule that would apply specifically to non-CIV funds but that would not replace the more general derivate benefit provision that appeared in the detailed version of the LOB rule included in the Report on Action 6. The Working Party is now looking at possible changes to that derivative benefits provision in the light of the new derivative benefits provision included in the United States Model Treaty released on 12 February 2016. Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the 'seven of fewer' condition of that derivative benefits provision. What other aspects of the new derivative benefits provision included in the United States Model Treaty would be problematic for non-CIV funds?

The US model treaty provision is problematic in that it should apply to any 'person other than an individual', and not just to 'companies'. This is required to reflect the fact that many non-CIV funds are constituted in a legal form which is not a 'company', such as a unit trust.

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

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

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

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

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

The proposal for a Global Streamed Fund regime is innovative, and deserves further review and consideration. At the core of the proposal would be the elimination of withholding tax at source and the remittance of taxes from the State of residence to the State of source. We believe that it should be possible to facilitate this, as it has been achieved before within the EU Savings Tax regime (albeit on a regional basis).

We would agree, though, that the GSF proposal raises challenges for non-CIV funds that do not distribute all their income on a current basis, and for non-CIV funds that cannot determine who their investors are. Operationally, the GSF proposal could be challenging to apply in practice, so any further consideration of the proposal would need to be mindful of the application on a day-to-day basis.

As a general principle, we strongly believe that tax rules should not be the key driver for the investment policy and strategy of an investment fund. If an investment fund wishes to make long-term investments, and roll-up any periodic returns into further re-investment, then the investment fund should be facilitated to do so. The global economy badly needs investors who make long-term investments, and investment funds (in particular, non-CIV funds) are one of the key investor classes now willing to make such long-term investments. Given this economic fact, we do not believe that tax rules should then effectively force those same investment funds to distribute their income on a current basis, thus imposing a short-term distribution policy on an investment fund looking to make a long-term investment.

For this reason, if the GSF proposal were to be adopted, it would need to be elective in nature. If a non-CIV fund wished to operate under the GSF regime, it should be able to elect to do so. However, if a non-CIV fund does not so wish, then such non-CIV must remain entitled to fall outside the GSF regime. This may arise because of either:

- the non-CIV is making a long-term, rolled-up investment, and its investment strategy does not involve the making of distributions on a current basis; or

- the non-CIV is widely-held with a dynamic change in ownership, in which case the non-CIV may not be able to determine the identity of the investors;

If a non-CIV did not elect to fall within the GSF regime, the non-CIV fund should be treated in line with the main principles of the LOB.

Due to the nature of the proposed regime, it would also require coherent changes in the domestic laws in the State of source to forego source taxation, the country of domicile of the fund (electing to fall

within the GSF regime) to withhold foreign taxes and clear rules allowing and indemnifying the fund on application of withholding tax on the basis of an investors attestation in respect of its treaty entitlements between the investors country of residence and the source country. In addition, there is likely to be requirement for bi-lateral or multi-lateral agreements between impacted countries providing for the collection and remittance of the withholding tax and audit/compliance procedures. As a result, the proposed GSF regime would require some fundamental legal infrastructure developments. This, in turn, would require a significant commitment from a broad base of countries to make this a viable option. In our view, these commitments in principle by countries should be given before the GSF regime becomes a practical and viable option.

3 Concerns related to the PPT rule

We believe that relevant and practical examples are crucial to the proper operation of the PPT rule. Given the range of approaches adopted by investment funds, it is important to have more than the single example currently included. We are available to meet with the OECD to discuss the practical scenarios for investment funds and suitable examples which could be included in the Commentary, and would be very happy to do so if that was found to be helpful.

At this stage, we would suggest the following examples be included in the Commentary:

Widely-held, regulated investment fund with two share classes

Note: in this example, underlined text is that which is different to the example for investment funds already in the Commentary.

RCo, a collective investment vehicle resident in State R, manages a diversified portfolio of investment assets, including assets which are not securities. RCo is subject to investor protection regulation in State R. The shares in RCo are widely-held. RCo has two classes of shares; the first class of shares are 'distributing' shares which give investors the right to annual distributions of income from RCo, and the second class of shares are non-distributing shares where RCo reinvests any income arising into further investment assets. A majority of investors holding shares in RCo are not residents of State R, and a number of these investors (a minority) are residents of States with which State S does not have a tax convention.

RCo currently holds 15% of its portfolio in shares of companies resident in State S, in respect of which it receives annual dividends. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30% to 10%.

RCo's investment decisions take into account the existence of tax benefits provided under State R's extensive tax convention network. Investors' decisions to invest in RCo are not driven by any particular investment made by RCo and RCo's investment strategy is not driven by the tax position of the investors.

In making its decision to invest in shares of companies resident in State S, RCo considered the existence of a benefit under the State R / State S tax convention with respect to dividends, but this alone would not be sufficient to trigger the application of paragraph 7. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment

was made. In this example, unless RCo's investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R / State S tax convention to RCo.

Widely-held, regulated investment fund with feeder funds

Note: in this example, underlined text is that which is different to the example immediately above for a 'Widely-held, regulated investment fund with two share classes' example.

RCo, a collective investment vehicle resident in State R, manages a diversified portfolio of investment assets, including assets which are not securities. RCo is subject to investor protection regulation in State R. <u>RCo is a 'master fund', and its shares are held by two 'feeder' funds. The shares in the two feeder funds are widely-held</u>. RCo has two classes of shares; the first class of shares are 'distributing' shares which give investors the right to annual distributions of income from RCo, and the second class of shares are non-distributing shares where RCo reinvests any income arising into further investment assets. <u>Investors in the feeder funds invest in matching share classes, so that the income paid on the 'distributing' shares by RCo to the feeder funds is on-paid by the feeder fund to the investors without deferral</u>. A majority of investors holding shares in <u>the feeder funds of</u> RCo are not residents of State R, and a number of these investors (a minority) are residents of States with which State S does not have a tax convention.

RCo currently holds 15% of its portfolio in shares of companies resident in State S, in respect of which it receives annual dividends. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30% to 10%.

RCo's investment decisions take into account the existence of tax benefits provided under State R's extensive tax convention network. Investors' decisions to invest in RCo are not driven by any particular investment made by RCo and RCo's investment strategy is not driven by the tax position of the investors.

In making its decision to invest in shares of companies resident in State S, RCo considered the existence of a benefit under the State R / State S tax convention with respect to dividends, but this alone would not be sufficient to trigger the application of paragraph 7. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, unless RCo's investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R / State S tax convention to RCo.

Yours sincerely,

Pat Lardner

Chief Executive