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Dear Sir/ Madam,

BEPS Discussion Draft: Treaty Entitlement of Non-CIV Funds

PricewaterhouseCoopers International Limited on behalf of its network of member firms (PwC) welcomes the opportunity to comment on the OECD's *Public Discussion Draft on the Treaty Entitlement of Non-CIV Funds*. Paragraph 9 of the Report on Action 6 OECD/G20 BEPS Project reaffirmed that collective investment vehicles (CIVs) should be entitled to treaty benefits. We commend the Working Party for its ongoing efforts to ensure that new treaty provisions emerging from the BEPS initiative also adequately address the treaty entitlement of non-CIV funds.

Our main comments broadly follow the organization of the Discussion Draft. For ease of reference, in Appendix 1 we also address each of the 28 questions raised, on a line by line basis.

Savings and investment are key contributors to a healthy global economy, and collective investment plays a vital role in efficiently employing investment capital. Paragraph 14 of the Report on Action 6 recognizes this economic importance of non-CIVs, and *"the need to ensure that treaty benefits be granted where appropriate"*. An investor in any fund, including a non-CIV, should not suffer a tax penalty merely for pooling its resources with other investors, and this "neutrality" should certainly be the case in any situation where the reason for investment is risk diversification or to secure economies of scale. This is particularly so for institutional investors such as pension funds and insurers, which generally are subject to regulation in their state of residence and whose investment spectrum may, as a result and because of a relative lack of in-house expertise in these more specialised areas, look to include alternative asset classes or private equity investments via committing capital to non-CIVs, often in significant individual tranches.

Alternative approaches are needed to achieve the goal of providing appropriate treaty access for the broad range of non-CIVs, without giving rise to treaty abuse. Many non-CIVs have a strongly diversified range of investments within a specific class, thus achieving the basic goal sought by investors of risk-spreading. Many also have a diverse investor base, some with a considerable turnover, and others with a very stable and often numerically smaller base. Funds often make use of a tiered structure, with a master fund owned by feeder funds, in order to accommodate the needs of different categories of investors. No one single approach can address this diversity of funds and structures.

The invitation to comment only raises specific questions relating to Action 6 measures and their effect on non-CIVs. We are concerned that this might mean that wider issues concerning the tax treaty entitlement of non-CIV fund vehicles and their commercially-driven corporate structures are less likely to be addressed. We believe that more funds (non-CIVs) which do not, as matters stand, meet the CIV criteria (i.e. being sufficiently widely held, subject to investor-protection regulation, and owning a diverse portfolios of securities) might appropriately be treated comparably to CIVs, and thus benefit directly from the treatment available to CIVs. This should be achieved through a widening of the "CIV" definition. Notably, the questions now raised, concerning how "widely held" and "regulated" ought to

be construed, should be set in the context of refining, clarifying and broadening the definition of "CIV", rather than in the narrower ambit of framing and interpreting an OECD Model LOB provision.

Similarly, further encouragement to governments, to work on implementing into more treaties the recommendations already in the Model Commentary regarding adding specific and detailed treaty text to deal explicitly with CIVs, should apply equally to what is currently regarded as the non-CIV space.

To make any proposed solutions effective, the Working Party should weight carefully the benefits and burdens of adding any additional compliance or reporting obligations for non-CIV funds, especially regarding their ultimate investors. Privacy concerns also need to be heeded. A number of our comments below are focused on these aspects.

In relation to the concerns in the Discussion Draft on the issue of deferral, we believe that income deferral is not inherently tax abusive. Were all deferral to be considered abusive, states would not need to structure CFC/PFIC type regimes to distinguish between "good" deferral and unacceptable deferral. Deferral should only be seen as an abuse in a limited field of situations, and these are often best addressed by the domestic regime of the investor state.

Limitation of benefits approach

Regulated or widely held

As noted above, more funds (non-CIVs) which do not currently meet the CIV criteria, ought, through a widening of the CIV definition, to be treated comparably to CIVs, and thus benefit directly from the treaty entitlement available to CIVs Increasingly, Alternative Investment Funds are being set up in, or moved to, regulated environment jurisdictions and, clearly pass the "regulated" test, and so if the "widely held" and "portfolio" tests were made a bit clearer and easier, they could then pass all three tests.

An exception to the LOB rule for non-CIV funds that are both widely held and regulated w0uld take into account the typical non-tax commercial purposes of these funds. As the Discussion Draft suggests, treaty shopping concerns in these types of situation are minimized by their very nature.

A widely held definition could require:

- a minimum number of ultimate beneficial owners (thereby allowing for tiered structures where there may be a master fund owned by two or more feeder vehicles which are owned by the ultimate investors), and
- no single ultimate beneficial owner may own more than a specified percentage (such as the 20% standard used in the Australian Investment Manager Regime regime), and
- no five or fewer ultimate beneficial owners may own over 50% of the fund.

In meeting the widely held test, a single institutional investor which is widely held may be considered to be equivalent to an investor base of a number of beneficial owners, on the basis that it represents a wide number of members/beneficiaries. A "managed account" real estate fund owned 98% by a widely held pension fund and 2% by the fund manager is common in the industry and may be as deserving of "neutrality" as a fund that has a very wide direct investor base.

Another type of fund that presents a low risk of treaty abuse is a fund with a diversified portfolio of investments, possibly combined with a requirement that the fund or its professional manager be regulated. If there is no regulator, whose basic principles for risk spreading may be applied, potential criteria for a diversified portfolio might relate to the following, applicable after a reasonable start-up period (although the specific thresholds should be subject to further discussion):

- average of 20 or more investments during the life of the fund, and
- no greater than 20% ownership of any single investment, and
- no single investment to exceed 20% of the NAV of the fund at the time the investment is made.

The "widely held" and "diversified portfolio" criteria may also be of particular relevance in considering the Commentary on the practical application of the PPT.

Transparency/ documentation

Given the growing move towards transparency, including measures such as CRS and FATCA which generally require the identification of beneficial owners, it would seem practical for ultimate investors to be required to provide the necessary documentation gathered to show the ultimate beneficial owner is resident in a treaty jurisdiction. We note, in that regard, that the US already has long-established documentation procedures that have proved effective, including forms for claiming entitlement to treaty benefits (Forms W-8 BEN (for individuals), W-8 BEN-E (for entities), W-8 EXP (for tax exempt entities), and W-8 IMY (for intermediaries). Withholding agents (whether it be the fund or a payer to the fund) can generally rely on the certifications in the forms.

If, as a general rule, a non-CIV fund has the option to claim treaty benefits on behalf of, or as a proxy for, its investors, that may allay the concerns attributable to the nature of some funds. This is common practice in the US for fiscally transparent entities. To the extent the fund is unable to determine the treaty status of any investor, it could apply the relevant source country domestic statutory rate on the proportionate income/ gains allocable to such investor. That investor, if eligible for treaty benefits under its treaty with the source country, could then file a refund claim under the source country's refund procedures. In our experience, withholding agents tend to take a conservative approach to determining the proper rate of withholding since they may otherwise be liable for the investor's tax, plus penalties and interest, with the possibility of limited recourse to the investor who may have already disposed of the investment at the time a tax authority alleges there has been an under withholding.

Although it may seem a burdensome and potentially impractical solution to adopt strict transparency requirements for purposes of the PPT, in situations where the information is not collected by the relevant fund and/or the fund entities do not want to share this information with paying entities, the full rate of withholding tax could be applied (as if all investors were in non-treaty jurisdictions).

Limited derivative benefits test

A derivative benefits test could prove to be an effective and important alternative for non-CIV funds that are not fiscally transparent or have a diversified investor base to qualify for treaty benefits while allaying fears about treaty shopping.

However, the proposal that each investor would have to be entitled to the same or better treaty rate as the non-CIV fund under their respective treaties with each source country seems unworkable where either the investors or the investments are geographically diverse. Consider, for example, a fund with investors from countries A, B, C, D, & E with investments sourced in countries X, Y, and Z – the fund would need to meet the equivalent rate test under 15 bilateral treaties. Treaties often have varying rates applicable to a given category of income and, in the case of dividends, different rates for companies and individuals and below we recommend a workable alternative that achieves the combined goals of preventing treaty abuse and a test of practical application.

The shortcomings of an equivalent rate test could be addressed if a derivative benefits test looked to whether a high enough percentage of investors were resident in states that have a comprehensive

income tax convention with the source country that provided a substantial reduction in the rate of tax applicable to the relevant category of income (the 'equivalent treaty test').

Allowing a fund with diverse investors to have a minority of investors that are not treaty qualified should not constitute treaty abuse where the fund was not established for the purpose of giving minority investors access to treaty benefits. We note in that regard that most of the tests in the currently proposed version of the LOB article in the OECD Model use a 50% threshold for ownership and, where applicable a 50% base erosion test. That is, the Model sets a standard that if benefits of the treaty are being enjoyed by a majority of 'good' owners (and, where applicable, recipients of base eroding payments), the entity is, per se, viewed as not treaty shopping and therefore entitled to the benefits of the treaty. We see no reason non-CIVs should be held to a higher standard than the classical corporate taxpayer that is subject to a 50% test. We note that the figure used in the 'simplified' version of derivative benefits clause in the BEPS final recommendations was 75% but that test is oriented to global corporate groups where ownership commonly is 80% or greater.

One option open to the Working Group, consistent with ensuring non-CIVs are entitled to treaty benefits where appropriate, is to provide two derivative benefits tests: one using an equivalent rate test and, perhaps a lower good ownership threshold because of the inherently limited scope of the test (mainly usable for funds whose ownership is concentrated in a single jurisdiction) and one using the above "equivalent treaty" test, making derivative benefits workable for funds with a diverse investor base, with a higher ownership threshold.

Under any of the above tests (broadly applicable in PPT situations as well), investors such as pension funds, governments or governmental funds, and charitable organizations should be treated as good investors as they would commonly be exempt from taxation had they directly received the investment income and cannot be treaty shopping by choosing to invest through a collective investment vehicle.

To the extent the Working Party opts to include an equivalent rate test, we note the 2016 US Model Treaty treats individual shareholders as companies for purposes of a similar rate comparison test (with respect to dividends). We note also that the 2016 US Model Treaty addresses the cliff-edge effect of an equivalent rate test – the tested entity can in appropriate circumstances apply the higher rate applicable in the treaty between the source country and the residence country of the owner of the tested company.

In order to take account of the fact that many funds use a master/feeder structure, it would be important to apply any derivative benefits test at the level of the ultimate beneficial owner.

Blended rate approach

A third approach might allow a fund to opt to use a blended rate of withholding (which might also apply where countries adopt a PPT approach). The concept would require the fund to determine the rate of withholding that would apply to each of its investors had they invested directly in the asset producing the income and weight these rates according to investors' percentage interests in the relevant income. The fund could then provide a worksheet to the withholding agent detailing its calculations available to the source country tax authority on request.

This approach could be implemented in a way consistent with the operation of current domestic law provisions in some countries (e.g. a system similar to this already applies in the US), which require recipient entities to submit documentation to paying entities in the source country that confirms who the ultimate investors are, where they are tax resident and what treaty benefits they qualify for. Based on this information, a blended withholding tax rate could be calculated and applied to payments made to the recipient entity. This reduces the unnecessary burden on the source state to determine what

withholding tax rate to apply (i.e. full rate or reduced rate as per double-taxation agreements), which could be complicated where there are a number of investors in multiple jurisdictions, and instead places the obligation on the holding companies themselves, to distribute the income to the relevant investors at the applicable rates.

The fund would be responsible for disaggregating the blended withholding tax paid and ensuring the ultimate tax cost was borne by the appropriate investors. Although there is a risk that investors in treaty jurisdictions might face undue tax at the expense of investors in non-treaty jurisdictions (e.g. if the fund did not disaggregate and applied the blended rate across all investors), we expect that the market will put the appropriate measures in place to ensure that the distributions are taxed correctly when paid to the investors. This will also be of relevance where the distribution received from the source state is not distributed, but is used to service/pay down debt at the investment company level.

Current international initiatives on information exchange (i.e. FATCA and CRS) include minimum reporting requirements that already require the information in respect of the identity of the ultimate investors in most investment schemes. As such, the information needed to calculate the blended rate should be readily available for most non-CIVs, even in complex tiered fund of funds structures. However, we note that it will be important for the funds to have reporting status under CRS for there to be a clear obligation to collect the data on investors and report it.

Sufficiently substantial connection

Given the diverse structures of non-CIVs, we have not attempted to address at this stage the suggestion made by some commentators and questioned by the OECD that a 'sufficiently substantial connection' test would be appropriate to entitle a non-CIV to treaty benefits.

Principal purposes test approach

We note the focus in the Discussion Draft on examples specifically relating to non-CIV funds that could be added to the Commentary on the PPT rule. We believe that it will also be necessary to define the terms "widely-held", and possibly "equivalent treaty test", in the Commentary, to give clarity to the scope of application of these examples.

The examples certainly need to reflect the key characteristic of very many non-CIV funds: the need, for good and legitimate commercial reasons, to have almost always one, and often more, corporate layers between the fund vehicle and the target investment asset. Without specific reference to detailed fact patterns, these commercial reasons may include:

- limitation of risk (e.g. to provide investors with contractual protection against personal liability for claims against the fund or individual assets),
- permitting effective co-investment by other parties into individual investments, thus further spreading risk and opening up investment opportunities,
- banking security, often requiring more than one level of holding company, to provide a pledge to be given over a single company's shares,
- administrative simplicity (e.g. a single legal shareholder owning investments, to provide a simpler acquisition and ongoing governance structure compared to multiple investors), and
- facilitating regulatory compliance and investor reporting, allowing a single entity management board to provide oversight of the entire portfolio.

The examples should also recognise and accept that this corporate structure will also tend be set up so as seek overall tax "neutrality" for investors, i.e., being driven by a "good" tax-related motive, rather than being a tax treaty shopping strategy.

On deciding the location of the corporate platform, the fund manager considers a range of factors, with particular emphasis on:

- stability and certainty in the political, regulatory, domestic tax and legal system as investments may be held for a number of years,
- clarity that the applicable corporate law permits timely and efficient cash extraction (e.g., in respect of a disposal of part of an investment),
- availability of suitable local premises, staff, administrative support and other professional advisors at a reasonable cost.

Bearing in mind these considerations, the examples in Appendices 2-5 distinguish elements of the application of the PPT in different scenarios.

Example A (see Appendix 2) describes a typical alternative investment structure, having a corporate "platform" beneath the fund vehicle. It confirms that, in part because the fund is "widely held", the application of the PPT should not be triggered when considering treaty access by the corporate platform entities.

Example B (see Appendix 3) describes another common type of alternative investment fund, having a corporate "platform" similar to that of Example A. Although not as widely held, the fund manager has sufficient knowledge of the fund investor base to be able to confirm that the majority of the capital invested in the fund comes from ultimate beneficial owners that can satisfy an "equivalent treaty" test. Consistent with our comments above concerning a limited derivative benefits test in the context of an LOB rule, this test would look at whether investors were resident in states that have a comprehensive income tax convention with the source country (i.e. where the fund's investment asset is located and for which treaty access is in point) which provided for a substantial reduction in the rate of tax applicable to the relevant category of income. Again it confirms that the application of the PPT should not be triggered because a minority of investors are not treaty qualified, so long as there was no purpose when the fund was established of giving minority investors access to treaty benefits.

Example C (see Appendix 4) considers the situation of an alternative investment fund that fits the fact patterns of either Example A or Example B but where the fund manager mainly conducts the management of the fund's assets from a state other than that where the corporate "platform" is resident. On the basis that this geographical separation occurs for good commercial reasons, it is confirmed that this factor should not affect the application of the PPT.

Example D (see Appendix 5) describes an alternative investment fund that has a notably diversified portfolio of investments. It confirms that this is a strong indicator of the absence of treaty abuse, and thus that the application of the PPT should not be triggered.

Distribution and deferral

The requirement for non-tax exempt investors to include their proportionate share of non-CIV fund income on a current basis would disadvantage funds established with the purpose of long term appreciation. A prime example is a fund that invests in an infra-structure project that may last for decades, with any earnings from the project reinvested to fund the on-going working capital needs.

We noted earlier that the concept of income deferral is not inherently tax abusive.

Many funds pool investor monies for long-term investment and growth and, therefore, reinvest the proceeds from any interim returns during the life of the fund. The re-investment decision for such funds is strictly for non-tax reasons while in other funds with no commercial reason not to distribute any return on investment to investors, it is usual to see the funds' terms demand current distribution.

Deferral should only be considered an abuse in limited situations. Improper deferral opportunities typically arise because of the specific application and interpretation of domestic tax anti-deferral regimes (or lack thereof). To that extent, while it is important to minimize the possibility for improper deferral opportunities, this is better addressed through appropriate domestic anti-deferral regimes since the tax being deferred is the tax in the investor's home jurisdiction. All investors in a fund should not be penalized because some investors are resident in jurisdictions that have not enacted adequate anti-deferral rules.

If there remains a concern over abusive deferral, a rolling multi-year mandatory distribution requirement as opposed to an annual distribution requirement would more realistically take into account the need to meet fund expenses as they arise as well as allowing for longer term, or at least medium term, objectives. A typical holding period for funds whose objective is capital appreciation is three to five years, although some funds hold for much longer periods, as in the case of infrastructure projects.

A current distribution requirement applicable to ordinary income rather than capital gains would be targeted to any potential abuse without depriving many funds that seek long term appreciation of treaty entitlement. However, requiring funds with a goal of long-term appreciation to currently distribute ordinary income would distort the funds' investment objectives. As noted, we believe abusive deferral is inherently self-policing since a fund that does not have long-term growth as an objective will be marketable only if the fund currently distributes its income and that requirement is often embedded in fund documents.

Other matters

- *Global Streamed Fund Regime* - We note that adopting a type of regime as described in the Discussion Paper would necessitate changes in the domestic tax laws of all participating jurisdictions. This may take several years. A Global Streamed Fund regime would however appear to be one viable solution to addressing treaty entitlement of certain non-CIV funds, were such changes to be implemented. The Working Group should therefore hold further extended consultations with interested parties on the Global Streamed Fund regime proposal, including with member states. A particular 'test-bed' area of focus might be funds which make long term investments in illiquid assets such as infrastructure.
- *Privacy Concerns* - Privacy of investor information is a critical concern. For example, a withholding agent may actually be in competition for clients with the fund manager, so the fund manager does not want to reveal its customer list to competitors. Investors may be concerned about disclosure of their investments for competitive reasons or personal security reasons. We believe it is of paramount importance to establish procedures that limit disclosure of investor names and investment details. The US, for example, allows intermediaries to act as "Qualified Intermediaries" that either report pooled information or assume the withholding responsibility with the investor information directly reported to the relevant tax authority and Withholding Foreign Partnerships and Withholding Foreign Trusts that agree to assume the withholding responsibility and provide the investor information directly to the relevant tax authority. The exchange of investor information between the tax authorities is limited to exchanges pursuant to an income tax treaty or exchange of information agreement whereby the requesting tax authority undertakes to protect the privacy of the information requested.

The period between publication of the Discussion Draft and the deadline for submissions has been relatively short so our response does not explore ideas in as much detail as our specialists might like.

However, we would be very keen to discuss with you any questions you have on the points we raise above or on other specific matters raised by respondents to the Discussion Draft.

Yours faithfully,

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APPENDIX 1

Concerns related to the LOB provision

Regulated and/or widely-held non-CIV funds.

1. What would be the threshold for determining that a fund is "widely held" for the purpose of such a proposal?

Response:
a. The definition should be aimed at whether there is a concentration of investment traceable to one or more investors. The use of an approach as detailed as the UK's "genuine diversity of ownership" test, may be considered as we set out in our June 2015 comment letter on Action 6. A definition based on the Australian test that requires that no investor hold a fixed percentage of the value of the fund (e.g., 20%) and no five or fewer investors own, in the aggregate, 50% of the fund might also be a workable approach.
b. It is important that the test take into account many funds involve tiered structures (which can be fund created, such as, the master/feeder structure, or investor created). Thus, the test should look to the ultimate beneficial owners.
c. It is important to also recognize that widely held funds will take time to build up to the targeted size. These funds often start with a select group putting up "seed money" and it may take more than a year to reach full operational size. Hence, there needs to be a start-up rule allowing a fund that is being offered to the public a couple of years of deemed widely held status.
d. Consideration should also be given to an alternative test for widely held for funds whose investments are geographically diverse (combined with a regulatory requirement).

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?
[A potential reference is made to regulatory requirements described in paragraph 16 of the 2010 IV report] What about disclosure requirements relating to distribution of interests?

Response:
a. Because each jurisdiction's regulatory regimes may vary, it is important to keep the regulation requirement generic. We suggest it should encompass general regulatory oversight. Examples could be included for greater certainty such as:

- EU - Transparency Directive, the Prospectus Directive, the Alternative Investment Fund Managers Directive and the Consolidated Admissions and Reporting Directive",
- US - US Securities Act of 1933, US Investment Advisers Act of 1940, US Dodd-Frank requirements, etc.

b. In many jurisdictions, it will be the asset manager, rather than the fund, that is subject to regulation. Thus, the regulatory requirement should be viewed as met whether it is the fund or the fund manager that is subject to the regulation. For example, the text of the EU's AIFMD confirms this, stating that "the objective of this Directive, namely to ensure a high level of investor protection by laying down a common framework for the authorisation and supervision of AI [Fund managers] ...".

c. It would be appropriate to require that the fund and fund manager be in compliance with all applicable anti-money laundering/know your customer laws and regulations and all other governmental rules or regulations relating to the knowledge of and/or disclosure of holders of interests in the fund.

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 entitle to the same or better treaty benefits with respect to income derived from that country. In that respect, how would this treaty-shopping concern be addressed?

> Response: It would be highly unusual for a fund that is going to be widely held to be formed with a principal purpose of obtaining treaty benefits. Further, the hypothetical situation of a widely held and regulated fund isolating its investments to a single country would be out of the norm.

4. Is it correct that investors in a non-CIV are typically taxable only when they receive a distribution?

> Response:
> a. That will vary depending on whether the investor's country of residence has enacted anti-deferral regimes, such as the US PFIC and CFC regimes.
> b. See our detailed discussion of deferral and distribution requirements.

Would there be mandatory distribution requirements for a fund to be eligible for the proposed exception (to the LOB rule) 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?

> Response: See our detailed discussion. In short, the fund's distribution policy should adequately address any concern about improper deferral. If the fund's investment objectives are long term growth, then interim returns on investment would be reinvested and to require mandatory distributions would distort the investment return. Not currently taxing re-invested returns for a fund with long term appreciation as its goal is not abusive; rather, currently taxing the return would be disruptive to the non-tax business reasons for the funds existence. Funds that do not have long term appreciation as an investment goal will almost always be required by their investors to distribute income on a current basis. For those funds, any concern about deferral is self-policed. Any concern about interim entities should be addressed under anti-deferral regimes, not by denying treaty benefits to the fund. This would be particularly troublesome when the intermediary is created by the investor rather than the fund. All investors would be penalized because a single investor used a tiered structure for its investment, regardless of whether the tiering was tax motivated or needed to meet a non-tax requirement of the investor's home country.

5. States that support the inclusion of LOB rules in their treaties are unlikely to agree to a broad exception 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?

> Response: The comparison to publicly traded corporations is misplaced. The proper comparison is to CIVs and widely-held non-CIVs have essentially the same positive features as CIVs and should be treated comparably. They are vehicles for collective investment which the OECD has recognised as being important to a healthy global economy. See our detailed response for our further discussion on widely held funds.

6. One argument that was put forward for excepting non-CIV funds from the LOB rule is that it would avoid/reduce cascading tax when the investment is made through various intermediaries. In practice, what is the intermediate entity-level tax, if any, which 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?

> Response: Intermediate vehicles are most commonly transparent and therefore tax neutral. In some cases, the intermediary may be non-transparent so as to centralise tax burden and reporting on the intermediary entity rather than exposing hundreds or thousands of investors to local tax payments and reporting in every jurisdiction where the fund invests. These intermediary vehicles are often used to accommodate specific restraints that may apply to, for instance, a governmental fund whose local laws restrict direct ownership of voting power in certain target investments. Intermediary vehicles, if they are not transparent, would typically be established in a jurisdiction that imposes little or no income tax. Hence, leveraging – from either related or unrelated parties – would have no tax impact.

Non-CIV funds set up as transparent entities

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 entitled to the benefits of the treaties concluded by that State?

> Response: As detailed in our comment letter, there are practical ways to deal with the proper identification of the ultimate beneficial owners, particularly with the growing acceptance of transparency and the advent of measures such as CRS and FATCA, as well as the TRACE project.

Limited Derivative Benefits Test

8. What is the meaning of "institutional investors" in the context of alternative funds? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition, 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 Funds". Why are institutional investors less likely to engage in treaty-shopping, as it has been suggested?

> Response:
> a. The term institutional investors is generic and its scope can vary.
> b. Generally, it is a reference to non-business entities such as pension funds, national government funds, state and local funds, college endowments and other charitable organizations. Common to most of these entities is that they are typically exempt from taxation. It should not be considered abusive to extend treaty benefits to an entity that is not taxable by its country of residence.
> c. To deny similar benefits to other entities, like insurers that carry out equivalent functions, to the extent that they are competing directly with such institutional investors and are not designed for abusive purposes, would seem to unfairly discriminate against their investors (including pensioners and the like).

9. Unlike CIVs, the term "non-CIV' has no established definition. What would be the main types of investment vehicles to which the proposal [the derivative benefits test] could apply?

Response: Common to all non-CIVs is the fact that they are vehicles for collective investment. The types of investment may vary considerably from equity to alternative sources of investment (such as debt instruments). However, common to these entities is that their investments are managed, directly or indirectly, by an investment manager.

10. The derivative benefits test proposal refers to the possible inclusion of "specific anti-abuse rules". What would these rules be?

Response: We note that anti-abuse rules discussed elsewhere in the BEPS project, including anti-deferral rules, conduit rules, and anti-hybrid rules, as well as the PPT for countries that choose to include a PPT in addition to an LOB, would continue to apply to a non-CIV qualifying under the derivative benefits test. In addition, the derivative benefits test has criteria for its applicability, would could be viewed as anti-abuse rules.

11. What would constitute a "bona fide investment objective"?

Response: The fact that a fund's investment manager is in the trade or business of providing investment services, is subject to general regulatory oversight, and has an investment management agreement with the fund should entitle any directly or indirectly managed investment vehicle to meet this bona fide investment objective.

12. How would it be determined that a fund is "marketed to a diverse investor base"?

Response: The burden of establishing this would be on the fund. Typically, there should be documentation available to support this assertion (e.g. PPM's, AIFMD filings).

13. Is the ownership of interests in non-CIV funds fairly stable or does it change frequently like the investors in a typical widely distributed CIV?

Response: This will vary from fund-to-fund. Some will have a stable set of investors that turn over infrequently; others, may have frequent turnover of investors.

14. How would the [derivative benefits test] proposal address the concern 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?

Response: In today's regulatory environment, most non-CIVs will have systems in place to track the ultimate beneficial owners as this will commonly be required under CRS, FATCA, and the like. In fact, the US withholding procedures require documentation of beneficial owners, including a requirement that any intermediary entity collect beneficial owner information from its owners and pass that information on down the chain of ownership. If the non-CIV cannot determine its beneficial owners, it will not be able to qualify under the derivative benefits test. This is further discussed in our comment letter.

15. What information do those concerned with the management and administration of non-CIV funds currently have concerning persons who ultimate own interests in the fund (e.g., under FATCA)?

Response: See response to Q.14.

16. Is this information sufficient for relevant parties to identify the treaty benefits that an owner would have been entitled to if it had received the income directly? If not, what type of documents and procedures could be used in that regard? What barriers would exist to the communication of these documents?

Response: See response to Q.14. See our comment letter for a discussion of privacy concerns and how to address those concerns.

17. Since beneficial interests in non-CIV funds are frequently held through a chain of intermediaries, including multiple subsidiary entities, how would the [derivative benefits test] proposal overcome the difficulties derived from such complex investment structures and ensure that a fund is not used to provide treaty benefits to investors that are not themselves entitled to treaty benefits?

Response: See above responses and the discussion in our comment letter.

18. Even a percentage as high as 80% of investors entitled to similar or better benefits would leave substantial room for treaty shopping as a 20% participation in a fund could represent a significant investment. How could this concern be addressed?

Response: We refer to the OECD Model LOB which generally accepts that if over 50% of the owners of a business entity are qualified and, where applicable, a base erosion test is met, the entity should *per se* be viewed as not abusing the treaty and fully eligible for treaty benefits, even if a substantial minority of investors may be resident in countries that do not have a relevant tax treaty. We do not believe non-CIVs, which the OECD has repeatedly acknowledged as serving an important role in a healthy global economy should be held to higher standard than business entities. This is discussed in further detail in our comment letter.

19. Wouldn't the 50% threshold proposed for the base erosion test be too generous?

Response: See our response to Q.18. Fundamentally, a 50% base erosion test is uniformly accepted for business entities (even in the case of the derivative benefits test of the OECD Model LOB, although, as detailed in our comment letter, we do not believe the Model's derivative benefits test is the right comparison).

Prevention of Deferral

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 is considered an acceptable anti-deferral regime (e.g., the US's PFIC regime)?

Response: The documentation requirements discussed in the context of Qs 14 – 16 addresses this question. Regarding what should be an acceptable anti-deferral regime, the decision should be at the discretion of the country of residence of the ultimate beneficial owner since it is that country's tax that is being deferred.

21. Who will be tested in relation to the condition that an ultimate owner is either tax exempt or taxed on a current basis (in regards to structures with various intermediate owners)?

Response: The derivative benefits test will need to define who is considered the ultimate beneficial owner. We believe the right answer to that is the first person up the chain of ownership that could have claimed equivalent benefits, however that is defined. (See the discussion in our comment letter of how an equivalent benefit should be defined.) If that person could have obtained equivalent benefits by investing directly, rather than through the non-CIV, there could be no treaty abuse. It is that person who should be tested under any anti-deferral regime. Our comment letter discusses the topic of deferral and the fact that deferral is not *per se* abusive.

The new derivative benefits test in the US Model

22. In addition to this potential derivative benefits rule that would apply specifically to non-CIV funds, the OECD is now looking at possible changes to the general derivative benefits provision that appeared in the Report on Action 6 in light of the new derivative benefits provisions include in the 2016 US Model Treaty. Based on previous comments, it is acknowledged that many non-CIV funds could not satisfy the "seven or fewer" condition of the US Model's derivative benefits provision. What other aspects of the 2016 US Model's derivative benefits provisions would be problematic for non-CIV funds?

Response: The US Model derivative benefits test should not be the standard for the non-CIV derivative benefits test. As discussed in our comment letter, the US Model test is mainly of significance for global corporate groups and the role of the non-CIV derivative benefits has a different aim entirely. The only relevant comparison is that both tests are based on the premise that if the owner(s) of the tested company could have received equivalent benefits directly, there is no treaty abuse. Further, the US Model derivative benefits test is excessively complex and most of the bases for this complexity are not relevant to non-CIVs. We would note, in particular, the proscription on intermediate owners severely limits the use of the test and we have discerned no meaningful policy justification for the intermediate owner limitation.

Non-CIV having Substantial Connection with its State of Residence

23. Are there practicable ways to design a "substantial connection"

Response: Given the diverse structures of non-CIVs, we have not attempted to address this proposal. We defer to those who have made the suggestion, while observing that Paragraph 19 of the Discussion Draft already identifies many relevant factors that could be used.

"Global Streamed Fund" Regime

24. Since this "Global Streamed Fund" regime is very recent, the OECD invites comments on its different features, particularly: (i) whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis; (ii) difficulties for non-CIV funds that cannot, for various reasons, determine who their investors; (iii) whether suggestion that on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties; and, (iv) what would be the consequences if it is subsequently discovered that the fund did not meet the requirements for qualifying as a Global Streamed Fund?

Response: As discussed in our comment letter, we believe this proposal is worthy of further consideration as an alternative. We stress, however, that it will take considerable time for implementation of the proposal as formulated and it is not a substitute for the alternatives presently under consideration.

Concerns related to the PPT rule

25. The OECD invites new examples to add to the Commentary on PPT which do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

> Response: We set out in our comment letter and in Appendices 2-5, some new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds.

Concerns related to "anti-conduit rules"

26. The OECD asks for examples if there are significant risks that the PPT rule could apply to some legitimate types of arrangements that are commonly entered into by non-CIV funds because these could be seen as conduit arrangements in the light of the examples already included in paragraph 19.

> Response: We are not providing any new examples in this area. However, we believe that the examples we have provided adequately address any concerns of treaty abuse and do not require any special anti-conduit rules beyond the anti-conduit rules a country choses to include as a general matter.

Concerns related to the "special tax regimes" proposal

27. The Report 6 recommendations will be redrafted in the light of the 2016 US Model Treaty that adjusted the definition of "special tax regimes". Is there any specific "statute, regulation or administrative practice" related to non-CIV funds that could constitute a special tax regime and that would give rise to concerns?

> Response: Any redrafting of the Report 6 recommendations based on the 2016 US Model Treaty that adjusted the definition of "special tax regimes" would require detailed consideration for all taxpayers. At this stage we do not see any justification for any different standard relating to non-CIVs.

Other suggestions

28. This question provides the opportunity to suggest any modifications to the Report on Action 6 not otherwise dealt with in Questions 1-27, to address issues related to the treaty entitlement of non-CIV funds.

> Response:
> a. We have provided specific comments in our letter which provide some alternative suggestions to those put forward. In particular, we draw attention to the comments on greater qualification of funds as CIVs; funds which are widely held or which have a diversified portfolio; alternative types of derivative benefits tests and the idea of allowing use of a blended rate of withholding.
> b. Further encouragement to governments to work on implementing into more treaties the recommendations already in the Model Commentary regarding CIVs, is not only felt to be important in the context of giving explicit treaty recognition to CIVs, but should extend to looking further into what is currently regarded as the non-CIV space. For example, the text of the new "post-BEPS" Germany-Australia double tax treaty, signed in November 2015 but not yet ratified, takes a small step in this direction by not only including as treaty text the paragraph 6.8 definition of a CIV, but extending it to core-style real estate funds.

APPENDIX 2

Principle Purposes Test
Example A – Widely held fund

A fund manager is looking to establish a new fund. The fund manager markets the prospective fund to a wide range of potential sophisticated (i.e. non-retail), investors, including pension funds, sovereign wealth funds, high net worth individuals, and other institutional investors, with the aim of having the fund widely held once fully invested. The mandate of the fund is to invest in a portfolio of existing, unrelated businesses, or a portfolio of real estate or infrastructure assets either to secure a stream of income or to benefit from appreciation in the capital value of these assets, and to manage these businesses or assets. A range of investors resident in different jurisdictions commit capital to the fund.

The platform for the fund comprises a "master" holding company established in State A, which is likely in due course to own sub-holding companies also established in State A. While some of the entities may only have a relatively low level of activity (consistent with the functions they perform) each will have a genuine economic reason for existing.

Funds will often include one or more corporates as part of the overall platform for a number of commercial reasons, and it is important to take these into account in the analysis. Without specific reference to detailed fact patterns, these reasons may include:

- limitation of risk (e.g. to provide investors with contractual protection against claims on the fund or individual assets),
- permitting effective co-investment by other parties into individual investments, thus further spreading risk and opening up investment opportunities,
- banking security often requiring more than one level of holding company to provide a pledge to be given over a single company's shares,
- administrative simplicity (e.g. a single legal shareholder owning investments to provide a simpler acquisition and ongoing governance structure compared to multiple investors), and
- facilitating regulatory compliance and investor reporting, allowing a single entity management board to provide oversight of the entire portfolio.

On deciding the location of the corporate platform, the fund manager considers a range of factors, with particular emphasis on:

- stability and certainty in the political, regulatory, domestic tax and legal system as investments may be held for a number of years,
- clarity that the applicable corporate law permits timely and efficient cash extraction (e.g., in respect of a disposal of part of an investment),
- availability of suitable local premises, staff, administrative support and other professional advisors at a reasonable cost.

It is possible that when the fund is initially launched, a smaller number of investors provide the initial seed capital for the fund which is then used to attract a wider investor base. The widely held investor base may take some time to establish (e.g. 2-3 years), but the fact that this wider base is not yet achieved, provided it can be demonstrated that the seed capital has been used to attract a wider investor base and the fund has been actively marketed during this time, should not preclude treaty benefits from applying in this initial period.

In making the decision to locate the platform in State A, the fund manager considers the existence of income tax conventions between State A and the states in which the target investments were likely to be resident, but this alone should not be sufficient to trigger the application of the PPT. At the time State A is chosen as the location for the platform (so it can be included in the marketing material), the identities of individual investors amongst the widely held investor base, and their tax attributes are still unknown. Unless the investments or the platform are part of an arrangement, or relate to another transaction, undertaken for a principal purpose of allowing investors indirectly to obtain the benefits of State A's tax conventions (such investors not satisfying an equivalent treaty test), it would not be reasonable to deny the benefit of these conventions to the platform companies.

APPENDIX 3

Principle Purposes Test
Example B – Known investor base

A fund manager is looking to establish a new fund. The fund manager markets the fund to a known investor base where the tax residence status of each investor is known and can be confirmed by the investors on an as-needed basis. The fund vehicle sets up a basic platform for the fund that is constituted by one or more holding companies established in State A.

The platform for the fund and the commercial reasons for structure and location are as in Example A.

In making the decision to locate the holding companies in State A, the fund manager considers the existence of benefits under the tax conventions between State A and the states in which the target investments were likely to be resident.

The majority of the investors in the fund are investors where it can be demonstrated that the investors would have qualified to use the appropriate treaty themselves, or would be equivalent beneficiaries under the terms of another state's tax treaty with the state where the investment is made.

The fund manager is able to use existing (or soon to be available) mechanisms such as CRS, FATCA or TRACE to confirm on a periodic basis that the significant investor base are entitled to equivalent benefits.

However, there will often not be 100% of investors in good treaty locations. Having a minority of investors that do not qualify for treaty benefits should not preclude the qualifying investors from obtaining their benefits if the intent of tax treaties in providing benefits (or preventing blockage) to encourage cross-border investment is to be maintained.

The main purpose of setting up the fund vehicle was commercially driven.

APPENDIX 4

Principle Purposes Test

Example C – Widely marketed fund – Investment management service location separated from holding company location

A fund manager is looking to establish a new fund. The fund manager markets the prospective fund to a wide range of potential sophisticated (i.e. non-retail), investors, including high net worth individuals, pension funds, sovereign wealth funds, and other institutional investors. The mandate of the fund is to invest in a portfolio of existing, unrelated businesses and to manage them. A range of investors resident in different jurisdictions commit capital to the fund.

The platform for the fund and the commercial reasons for structure and location are as in Example A.

In this example, the management vehicle for the fund vehicle is based in State B where the activities constituting day to day management of the assets within the fund take place.

The location of the management vehicle is chosen primarily so that the fund manager group is best able to draw on a wider pool of investment and management advisors as well as have access to better ancillary services in State B than is available in State A. However, State A offers a more commercial location in which to set up the fund platform.

In making the decision to locate the holding companies in State A, the fund manager did consider the existence of income tax conventions between State A and the states in which the target investments were likely to be resident but this alone should not be sufficient to trigger the application of the PPT for the same reasons as in Example A.

The location of the management vehicle for the fund should not have any impact on the analysis as this has been located outside State A for commercial reasons as State B gives the fund access to a much wider range of investment and other specialists than is available in State A.

APPENDIX 5

Principle Purposes Test

Example D – Non-CIV funds with a diversified portfolio

A fund manager is looking to establish a new fund. The fund manager markets the prospective fund to a wide range of potential sophisticated (i.e. non-retail), investors, including high net worth individuals, pension funds, sovereign wealth funds, and other institutional investors. The mandate of the fund is to invest in a portfolio of existing, unrelated businesses and to manage them. A range of investors resident in different jurisdictions commit capital to the fund.

The platform for the fund and the commercial reasons for structure and location are as in Example A.

In this example, the non-CIV fund may not over time achieve a diverse investor base.

Notwithstanding the lack of a diverse investor base, a fund structure that could still present a low risk of treaty abuse is a fund with a diversified portfolio of investments, especially where this is combined with a requirement that the fund or its professional manager is regulated in order to gain access to appropriate treaties.

We have outlined below potential criteria that may be identified for a diversified portfolio:

- average of 20 or more investments during the life of the fund, and
- no greater than 20% ownership of any single investment, and
- no single investment to exceed 20% of the NAV of the fund at the time the investment is made.

Unless the investments or the platform are part of an arrangement, or relate to another transaction, undertaken for a principal purpose of allowing investors indirectly to obtain the benefits of State A's tax conventions (such investors not being equivalent beneficiaries under the terms of another state's tax treaty with the state where the investment is made), it would not be reasonable to deny the benefit of these conventions to the fund's platform companies.