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AMERICAN INVESTMENT COUNCIL
Growth Through Long-Term Investment

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Submitted electronically to taxtreaties@oecd.org

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Re: Response to OECD Public Discussion Draft BEPS Action 6: non-CIV examples (6th January 2017).

Introduction:

Invest Europe and the American Investment Council are pleased to send you our comments on the discussion draft. The private equity industry welcomes the publication of the discussion draft on draft examples for inclusion in the Commentary on the Principal Purposes Test (PPT). We acknowledge that the overall process of assimilating feedback from previous discussion drafts has been less than straightforward and we are appreciative that the OECD has now come up with solutions that address treaty shopping issues while still aiming to allow legitimate, tried-and-tested fund structures to continue to perform their role. In line with our commitment to finding a suitable solution to the question of treaty access for private equity funds, we have now responded to all five OECD Action 6 consultations with the submission of this paper.

We expect the Principal Purposes Test (PPT) will be adopted by many countries through the Multilateral Framework. Given the subjective nature of the PPT, there is a risk of increase in uncertainty and controversy for the non-CIV sector without further guidance. Thus, we support the inclusion of clear and realistic examples in the OECD Model Tax Convention Commentary.

As explained in the discussion draft, the OECD "decided that it would be inappropriate to add a large number of additional examples and considered that it would be possible to add up to three examples that would pick up various elements found in the commentators' suggested examples that dealt with common transactions." In this light, we presume that each example is not intended to operate as a mutually-exclusive rigid test, but rather that there is flexibility for common themes and requirements in the three different examples to be applied to real-world examples, i.e. they will be illustrative examples, rather than prescribed models.

General Comments on the Examples:

The draft examples presented in the discussion draft provide a helpful starting point, but improvements are needed to prevent unwarranted negative implications for the private equity industry. Most importantly, we believe that examples where no tax benefit can be identified (e.g., where the ultimate investors are full equivalent beneficiaries) should not be included in the Commentary.

Further below in this response, we provide specific comments on examples 1 and 3, along with our rationale for the proposed changes. We note the comment in the discussion draft that no consensus has yet been reached on the draft examples. We would like to emphasize the importance of having clear and realistic examples in the Commentary.

While we recognize and support the strength of consensus decision-making by the Inclusive Framework on BEPS Implementation, we would find it extremely unfortunate if this lack of consensus would lead to examples that reflect the lowest common denominator or, in the worst case scenario, leads to no examples being included at all. If such agreement cannot be reached, we would like to ask the source countries willing to come to a common agreement in a way that makes it possible for non-CIV funds to continue to pursue commercial investment opportunities in those source countries without excessive negative impacts due to Action 6, to confirm so through an external communication. This could for example be done by agreeing to examples reflecting a common interpretation of the PPT in a Multilateral Generally Applicable Competent Authority Agreement.

Specific Comments on the Examples:

Our comments here are directed at example 1 (Regional Investment Platform) and example 3 (Immovable Property Non-CIV Fund).

Example 1: Rationale for Comments

- The very specific nature of the facts included in this example creates uncertainty for fact patterns that fall slightly outside those presented. This is in particular the case when the difference relates to facts that, in our opinion, are not crucially important for the conclusion. For example, the fact that a country is part of a regional grouping and a regional currency will in practice mean that the example only provides certainty if the holding and all investments are located in the monetary union of the EU. It excludes similar regional platforms in other regions, such as Asia. We assume that is not the intention.
- Secondly, it seems to us that a similar conclusion should be reached in case the holding is held by a transparent fund bringing together a number of institutional investors, under the condition that the fund structure is set up and managed by a professional and regulated investment

manager, which has set up multiple investments in the region of the holding company and which has carefully chosen the holding country for the specific fund structure because of the reasons given in the example.

- Thirdly, we suggest to replace the word 'employs' with the word 'engaged' in the sentence "RCo employs an experienced local management team to …". The word "employs" seems to imply that only an employer-employee relationship between RCo and the local management team would be acceptable. RCo could have access to the same substance in Country R through other means, for example by contracting with an affiliated entity employing such personnel, engaging the services of investment manager personnel, or hiring independent contractors in Country R.
- Finally, it would be important for the non-CIV industry to receive confirmation that a variation on this factual situation will lead to the same conclusion. For legal, governance, liability and funding reasons, it may be that the regional platform materially functions in the same fashion as described in the example, but that instead of one holding company for all investments, separate entities are set up to carry out the investment activities. These entities are all located in the same holding country and the difference in the organizational structure compared to a single holding company situation does not have an impact on the tax position in the specific country. To address this concern, a paragraph could be added at the end of the example indicating: "The conclusions in this example will be the same for a fact pattern whereby all the facts and circumstances are comparable, except for the fact that the fund, for legal, governance, liability and funding reasons sets up a separate holding entity in State R for each separate investment or for certain categories of investments. In order to receive the same treatment the use of multiple holding companies should not lead to relevant differences in the taxation of the investments."

Proposed Mark-Up

Regional Investment Platform example

RCo, a company resident of State R, is a wholly-owned subsidiary of a Fund, an institutional investor that is a resident of State T and that was established and is subject to regulation in State T [We suggest adding either in the main text or in a footnote, the following language: "or could also be a wholly-owned subsidiary of a State T partnership treated as fiscally transparent under the domestic tax law of State T, bringing together a wide range of investors and established by a regulated professional investment management company."]. RCo operates exclusively to generate an investment return as the regional investment platform for Fund through the acquisition and management of a diversified portfolio of private market investments located in countries in a

regional grouping that includes State R. The decision to establish the regional investment platform in State R was mainly driven by the availability of directors with knowledge of regional business practices and regulations, the existence of a skilled multilingual workforce, *State R's membership of a regional grouping and use of the regional grouping's common currency* [We suggest to delete the language in italics or to replace it with other language reflecting a link to the region.] and the extensive tax convention network of State R, including its tax convention with State S, which provides for low withholding tax rates. RCo *employs* [We suggest to replace the language in italics with the word "engages"] an *experienced* [We suggest to replace the language in italics with "a qualified"] local management team to review investment recommendations from Fund, approve and monitor investments, carry on treasury functions, maintain RCo's books and records, and ensure compliance with regulatory requirements in States where it invests. The board of directors of RCo is appointed by Fund and is composed of a majority of State R resident directors with expertise in investment management, as well as members of Fund's global management team. RCo *pays* [We suggest to replace the word in italics with "is subject to"] tax and files tax returns in State R.

RCo is now contemplating an investment in SCo, a company resident of State S. The investment in SCo would constitute only part of RCo's overall investment portfolio, which includes investments in a number of countries in addition to State S which are also members of the same regional grouping. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30 per cent to 5 per cent. Between State S and *State T* [We suggest to replace the language in italics with: "the residence state of the investors."], the applicable withholding tax rate on dividends *is 10 per cent*. [We suggest to replace the language in italics with: "varies and in most cases is higher than 5 per cent."]

In making its decision whether or not to invest in SCo, RCo considers 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, including the reasons for establishing RCo in State R and the investment functions and other activities carried out in State R. In this example, in the absence of other facts or circumstances showing that 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. [We suggest adding the following language at the end of the example: "The conclusions made in this example are the same for a fact pattern whereby all the facts and circumstances are comparable, except for the fact that the Fund for legal, governance, liability and funding reasons sets up a separate

holding entity in State R for each separate investment or for certain categories of investments. The use of multiple holding companies should lead to similar taxation of the investments."]

Example 3: Rationale for Comments

- Firstly, we would like to suggest broadening the language to make clear that this example includes additional types of private market investments other than real-estate investments.
- Secondly, we would like to mention that the comment made in the regional platform example on the use of separate holding companies per investment is also relevant for this example.
- Finally, we believe the example as it is written now is too restrictive as it only applies if all of the investors are equivalent beneficiaries, which is inconsistent with the existing CIV example in the Commentary. We would therefore like to call on the OECD / the Inclusive Framework on BEPS Implementation to consider reflecting a threshold in this example that in effect is similar to the one reflected in the existing CIV example, Example D. In Example D relating to treaty entitlement of CIVs, a majority of the investors in RCo were residents if State R but a number of investors were residents of States with which the source state did not have a tax treaty. Thus, one possibility would be to include the following language in the non-CIV example, which draws on the language used in the already agreed to CIV Example D: *"A wide and diverse group of investors has invested in the Fund. The majority of these investors are residents of countries that have tax treaties with the investment country under which the investor would have received equivalent treaty benefits as the benefits to which Holdco is entitled, if the investor owned the same interest in the investment country.*"

Proposed Mark-Up

Immovable Property non-CIV fund example

Real Estate Fund, a State C partnership treated as fiscally transparent under the domestic tax law of State C, is established to invest in a portfolio of real estate investments in a specific geographic area. [We suggest that a footnote be included indicating the analogous applicability to other types of private market investments.] Real Estate Fund is managed by a regulated fund manager and is marketed to institutional investors, such as pension schemes and sovereign wealth funds, on the basis of the fund's investment mandate. A range of investors resident in different jurisdictions commit funds to Real Estate Fund. The investment strategy of Real Estate Fund, which is set out in the marketing materials for the fund, is not driven by the tax positions of the investors, but is based on investing in certain real estate assets, maximising their value and realising appreciation through the disposal of the investments. Real Estate Fund's investments are made through a

holding company, RCo, established in State R. RCo holds and manages all of Real Estate Fund's immovable property assets and provides debt and/or equity financing to the underlying investments. RCo is established for a number of commercial and legal reasons, such as to protect Real Estate Fund from the liabilities of and potential claims against the fund's immovable property assets, and to facilitate debt financing (including from third-party lenders) and the making, management and disposal of investments. It is also established for the purposes of administering the claims for relief of withholding tax under any applicable tax treaty. This is an important function of RCo as it is administratively simpler for one company to get treaty relief rather than have each institutional investor process its own claim for relief, especially if the treaty relief to which each investor would be entitled as regards a specific item of income is a small amount. After a review of possible locations, Real Estate Fund decided to establish RCo in State R. This decision was mainly driven by the political stability of State R, its regulatory and legal systems, lender and investor familiarity, access to appropriately qualified personnel and the extensive tax convention network of State R, including its treaties with other States within the specific geographic area targeted for investment. *RCo, however, does not obtain treaty benefits that are better than the benefits to which its investors would have been entitled if they had made the same investments directly in these States and had obtained treaty benefits under the treaties concluded by their States of residence.* [We suggest replacing the language in italics with: "A wide and diverse group of investors has invested in the Fund. The majority of these investors are residents of countries that have tax treaties with the investment country under which the investor would have received equivalent treaty benefits as the benefits to which Holdco is entitled, if the investor owned the same interest in the investment country"].

In this example, whilst the decision to locate RCo in State R is taken in light of the existence of benefits under the tax conventions between State R and the States within the specific geographic area targeted for investment, it is clear that RCo's immovable property investments are made for commercial purposes consistent with the investment mandate of the fund. Also RCo does not derive any treaty benefits that are better than those to which [the majority of] its investors would be entitled and each State where RCo's immovable property investments are made is allowed to tax the income derived directly from such investments [We suggest adding a footnote here indicating that if the investment is made in property other than immovable property, the language should be read to reflect that the income earned by Rco is subject to tax in State R]. In the absence of other facts or circumstances showing that RCo's investments are part of an arrangement, or relate 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 tax treaties between RCo and the States in which RCo's immovable property investments are located. [We suggest adding the following language at the end of this example: "The conclusions made in this example are the same for a fact pattern whereby all the facts and circumstances are comparable, except for the fact that the Fund for legal, governance, liability and funding reasons sets up a separate holding

entity in State R for each separate investment or for certain categories of investments. The use of multiple holding companies should lead to similar taxation of the investments].

Conclusion:

Private equity funds are not in the business of treaty shopping. The primary purpose of private equity, just like other non-CIVs, is a business purpose, i.e. the co-investment arrangement or pooling of capital to make investments. Tax treaty access will remain crucial in order to achieve tax neutrality for funds, and to avoid double or even triple taxation in genuine bona fide investment structures.

The private equity industry fully appreciates the concerns of the OECD that action is needed to effectively prevent double non-taxation, as well as cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it.

We would be delighted to discuss this letter or any other issues relating to the private equity industry if you have further questions.

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