MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

February 3, 2017

Via email: taxtreaties@OECD.org

Tax Treaties
Transfer Pricing and Financial Transactions Division
OECD/CTPA
2, rue André Pascal
75775 Paris Cedex 16
France

Re: Managed Funds Association Comments on Discussion Draft on Non-CIV Examples

Dear Sir / Madam:

The Managed Funds Association[1] appreciates the opportunity to submit for your consideration comments regarding the Organisation for Economic Co-Operation and Development's ("OECD") consultation document on Non-CIV Examples, as part of its Base Erosion and Profit Shifting ("BEPS") project. As noted in our prior submissions to the OECD,[2] we support the goals underlying the OECD's project of preventing tax abuse in connection with granting tax treaty benefits.

Subjecting investors an additional layer of tax because they choose to invest through a pooled investment vehicle rather than investing directly in capital markets would be a significant change in longstanding tax policy and would impose a significant new cost on investors. Also as noted in our prior letters, to the extent sophisticated investors, including institutional investors, pension plans, sovereign funds, endowments, and charitable foundations, would be subjected to an additional layer of tax simply because they choose to invest through a pooled vehicle, they likely would no longer choose to invest through that type of asset management structure. Those investors that forego such investments would

[1] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

[2] *See,* MFA's April 22, 2016 comment letter on the OECD's consultation document on the Treaty Entitlement of Non-CIV Funds, available at: https://www.managedfunds.org/wp-content/uploads/2016/04/MFA-Letter-on-OECD-Consultation.pdf. *See also,* MFA's June 12, 2015 comment letter to the OECD, available at: https://www.managedfunds.org/wp-content/uploads/2015/06/MFA-Letter-on-OECD-Discussion-Paper-Action-61.pdf.

thereby forego the potential returns they generate from investing in private funds, and the available private fund capital for international investment would shrink to that extent. This result would ultimately adversely affect cross-border investing activities and global capital markets that rely on such cross-border investments.

As shown on the following chart, which is derived from Preqin's 2016 Global Hedge Fund Report,[3] a significant amount of the capital invested in hedge funds, which are a particular type of private investment fund, comes from tax-exempt investors such as public and private sector pension plans.

Breakdown of Institutional Investor Capital Invested in Hedge Funds by Investor Type

	As of	
	Dec-14	Dec-15
Public Pension Fund	20%	23%
Private Sector Pension Fund	19%	19%
Sovereign Wealth Fund	11%	11%
Endowment Plan	11%	11%
Asset Manager	10%	8%
Foundation	8%	9%
Insurance Company	7%	7%
Bank	6%	3%
Family Office	3%	2%
Wealth Manager	3%	3%
Corporate Investor	1%	0%
Superannuation Scheme	1%	1%
Other	1%	1%

We appreciate the work of the OECD Action 6 working group in developing examples of non-CIV arrangements that could qualify for treaty benefits under the "principal purpose test." We are concerned, however, that the examples provided in the discussion draft are overly prescriptive and likely would unnecessarily exclude many private investment funds. We also are mindful of the concerns expressed by the working group about having excessive numbers of examples. As such, we encourage the working group to modify examples 1 and 3, consistent with our specific suggestions to the discussion draft set out below, in light of the variety of investment strategies and business structures that non-CIVs use to accomplish their investment objectives for institutional investors. We also encourage the working group to confirm that the examples are intended to be illustrative of non-CIVs that could qualify for treaty benefits under the principal purpose test and not intended to be an exhaustive list of the types of non-CIVs that could so qualify.

[3] Preqin's 2016 Global Hedge Fund Report is available (fee required) at: https://www.preqin.com/item/2016-preqin-global-hedge-fund-report/2/13359.

Example 1

MFA is concerned that certain aspects of the description of the non-CIV fund and the operational functions of the regional investment platform in example 1 are inconsistent with the business structure of almost all non-CIV funds and, as such, may limit the relevance of the example, as drafted. In particular, we believe that the description of the fund in example 1 does not adequately capture the structure of non-CIV funds that are marketed to a broad range of investors that are resident in a variety of jurisdictions. Additionally, while we support the requirement for a non-CIV fund to have sufficient business substance in a State for which treaty benefits are sought, we believe the description in example 1 is not particularly applicable to many non-CIV funds. For instance, certain functions of the non-CIV fund, such as treasury functions, are often performed from a location separate from the country where the regional investment platform operates and this geographical separation occurs for legitimate commercial reasons including, but not limited to, administrative simplicity and centralised management. Accordingly, we encourage the working group to modify the language in example 1 as set out below.

1. Regional investment platform example

Example [XX]: RCo, a company resident of State R, is a wholly-owned subsidiary of Fund, which is either (a) an institutional investor that is a resident of State T and that was organised ~~established~~ and is subject to regulation in State T; or (b) an entity organised in State T that is treated as fiscally transparent under the domestic tax law of State T and that is managed or advised by a regulated fund manager and marketed to investors, including institutional investors, resident in different jurisdictions. Fund invests in a diverse portfolio of investments around the world. The investment strategy of Fund is not driven by its tax positions or the tax positions of its investors, but is based on investing in certain assets, earning income from those assets and realising appreciation through the disposal of the investments.

RCo operates primarily ~~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~~, and the extensive tax convention network of State R, including its tax convention with State S, which provides for reduced ~~low~~ withholding tax rates. RCo employs an experienced local personnel ~~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 portfolio ~~global~~ management team, who routinely meet to approve investment recommendations from the Fund. RCo is subject to ~~pays~~ 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 is expected to include~~s~~

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. Under the tax convention between State S and State T, the withholding tax rate on dividends is 10 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.

Example 3

We further encourage the working group to modify example 3 in the discussion draft to apply to a broader range of non-CIVs, regardless of the type of asset that the fund invests in or the investment strategy that the non-CIV uses. For the sake of clarity, our suggestions to expand the example to include a broader range of assets that many non-CIVs invest in are not intended to exclude real estate assets.

Moreover, where the non-CIV fund itself or an entity set up by the non-CIV fund is established in a certain jurisdiction for legitimate business reasons that are not principally motivated by obtaining treaty relief, we do not believe that application of the principal purpose test should require that no investor at all can obtain treaty benefits that are better than the benefits it would have been entitled to if it invested directly. In that regard, we note that some investors may obtain both better and worse tax treatment, depending on the nature of the income earned by the non-CIV, which we believe further supports the view that the proposed bright line test should not be adopted. We further note that this requirement does not exist in example 1 in the discussion draft, which specifically contemplates a potential tax benefit as a result of RCo's decisions. We believe that the denial of treaty benefits to a non-CIV that otherwise conformed to the fact pattern set out in example 3 would run counter to the overall objective of encouraging continued cross-border investment growth, and would be inconsistent with the application of the principal purpose test to other taxpayers (which may, for example, have a minority of shareholders residing in non-treaty partner States).

3. ~~Immovable property non-CIV fund~~ Global investment platform example

Example [XX]: ~~Real Estate~~ Global Investment Fund, a State C partnership treated as fiscally transparent under the domestic tax law of State C, is established to invest in a diverse portfolio of ~~real estate~~ investments ~~in~~ around the world ~~a specific geographic area~~. ~~Real Estate~~ Global Investment Fund is managed or advised by a regulated fund manager and is marketed to ~~institutional~~ investors, including institutional investors such as pension schemes and sovereign wealth funds, on

the basis of the fund's investment mandate. A range of investors, which may be resident in different jurisdictions, commit funds to ~~Real Estate~~ Global Investment Fund. The investment strategy of ~~Real Estate~~ Global Investment 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~~ earning income from those assets and realising appreciation through the disposal of the investments. ~~Real Estate~~ Global Investment Fund's investments are made through a holding company, RCo, established in State R. RCo holds and manages substantially all of ~~Real Estate~~ Global Investment Fund's investments located in countries in a regional grouping that includes State R, ~~immovable property assets~~ and provides debt and/or equity financing to the underlying assets ~~investments~~. RCo is established for a number of commercial and legal reasons, such as to protect ~~Real Estate~~ Global Investment 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~~ Global Investment 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 areas 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.~~ 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 areas 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 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~~. 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 for ~~in which~~ RCo's ~~immovable property~~ investments ~~are located~~.

To the extent the working group decides not to adopt the above suggestions to modify examples 1 and 3, (because, for example, the working group decides to include a specific example regarding immovable property) we encourage it to develop a fourth example for global investment firms that receive only proportional treaty benefits, regardless of the type of investments the non-CIV makes and the investment strategies it pursues. We also encourage the working group to ensure that whatever examples are ultimately adopted provide sufficient flexibility to be applicable to the range of non-CIV structures that exist for legitimate business reasons.

Further, we continue to encourage the OECD to adopt a framework that permits non-CIVs to qualify for proportional treaty benefits, to the extent that ultimate investors in a fund would be

entitled to treaty benefits if they had made the investment directly, rather than through a pooled investment fund. To accomplish this proportional benefits framework, and as we noted in our April 2016 letter, we strongly support the adoption of the investor self-certification system developed in TRACE, or other effective and efficient investor self-certification system, as a mechanism to document the investor's tax status and remit the appropriate information to tax authorities. We believe that providing such proportional treaty benefits to non-CIVs that are regulated , such as Irish Qualifying Investor Alternative Investment Funds or Luxembourg Specialised Investment Funds, or that have investment managers or investment advisers subject to regulations, such as under the Alternative Investment Fund Managers Directive in the EU or the Investment Advisers Act of 1940 in the U.S., is consistent with the purpose of promoting cross-border investments as well as the anti-tax abuse purpose of the BEPS project.

Conclusion

If you have any questions regarding any of the issues or modifications discussed above, or if we can provide further information with respect to the application of treaty benefits to private investment funds, please do not hesitate to contact Benjamin Allensworth or me at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell

Executive Vice-President and Managing Director, General Counsel