

Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development

By email: taxtreaties@oecd.org

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Dear Sir/Madam

OECD consultation: Treaty entitlement of non-CIV funds

The Association of Real Estate Funds (AREF) welcomes the opportunity to respond to the OECD's consultation on the treaty entitlement of non-CIV funds.

A critical feature of any fund is that it secures for its investors the same, or substantially the same, tax treatment as direct investment. This feature was recognised by the OECD in its 2010 report 'The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles'. It is therefore essential that non-CIV funds and/ or their investors are able to benefit from treaty entitlement; without it tax neutrality would be lost. However, we understand the OECD's concerns in relation to treaty shopping and deferral of the taxation of income.

According to the OECD's 2010 report, the term CIV means a fund which is widely-held, holds a diversified portfolio of securities and is subject to investor-protection regulation in the country in which it is established. A non-CIV fund should be a fund which fails at least one of these three conditions. We consider that it would be helpful to re-visit the definition of CIV. For example, it seems odd to determine whether or not a fund is a CIV based on the asset class in which it invests. As it currently stands, real estate funds cannot be CIVs as they invest in the wrong type of asset. We consider that it should be possible for a real estate fund to be a CIV. However, it would not be essential for the Model Tax Convention and Commentary fully to define all terms. For example, it may be preferable and/ or simpler for the States involved in bilateral treaty negotiations to specify the meaning of regulated.

We do not consider a broad exception from the LOB rule on the basis that a fund is widely-held or regulated to be the best approach.

For most real estate funds, it should be possible to identify the ultimate investors. Treaty entitlement determined on the basis of investor eligibility would seem a good option, although its administration would need careful thought. We support the LOB including a derivative benefit rule as a pragmatic approach. If there were a need to identify and assess the status of every investor for treaty entitlement, being unable to gather this information for a single investor would adversely affect all investors in the fund.

The Association of Real Estate Funds (AREF) represents the UK real estate funds industry. It has about 65 members with a collective net asset value of around £60 billion under management on behalf of investors. This includes around £20 billion in UK authorised retail funds and similar amounts in various forms of UK unregulated collective investment vehicles (CIVs) and in offshore domiciled funds. Member funds represent about two-thirds of UK commercial real estate held in CIVs.



Almost all, if not all, treaties give taxing rights over income from real estate to the State in which the real estate is situated. This means that tax is levied at the fund level for a real estate fund, so deferral of tax may be less of a concern than for other types of fund.

In the appendix, we respond to the consultation questions of particular relevance to property funds. We would welcome the opportunity to discuss the impact of the consultation proposals on property funds in more detail.

I am available at your convenience to discuss anything in this letter.

Yours faithfully

A handwritten signature in black ink, appearing to read "John Cartwright", written over a horizontal line.

John Cartwright
Chief Executive
The Association of Real Estate Funds

APPENDIX

SUGGESTION THAT TREATY BENEFITS BE GRANTED TO REGULATED AND/OR WIDELY HELD NON-CIV FUNDS

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

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

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

It should be possible to classify a fund either as a CIV or as a non-CIV. According to the OECD’s 2010 report, a CIV is a fund which is widely-held, holds a diversified portfolio of securities and is subject to investor-protection regulation in the country in which it is established. A non-CIV should be a fund which fails at least one of these three conditions.

In the context of CIVs, the purpose of the widely held concept is to help overcome otherwise insurmountable problems with identifying and establishing treaty eligibility of the many diverse investors of a fund that is broadly distributed to a retail market. In contrast, for most real estate funds, it should be possible to identify the ultimate investors. Treaty eligibility on the basis of investor entitlement would seem a better option, although dealing with this from an administrative point of view would need careful consideration.

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

Almost all, if not all, treaties give taxing rights over income from real estate to the State in which the real estate is situated. This means that tax is levied at the fund level for a real estate fund, so deferral of tax may be less of a concern than for other types of fund.

In relation to offshore funds, including real estate funds, UK investors are subject to tax on income of the fund regardless of whether distributions are made. Some other jurisdictions have similar rules.

For a real estate fund, mandatory distribution of either property income or capital gains would be undesirable. This is because there is a regular need to maintain and invest in existing real estate assets.

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

As explained in our answer to questions 1 – 3, we do not consider a broad exception from the LOB rule on the basis that a fund is widely-held or regulated to be the best approach.

NON-CIV FUNDS SET UP AS TRANSPARENT ENTITIES

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

We support the suggestion that a non-CIV be able to elect to be treated as fiscally transparent, but that it is a matter of domestic law and not an option to be made available via treaties themselves.

For example, the UK PAIF regime is elective. Although a PAIF is not transparent as such (it takes corporate form), only the investors are taxed on property business profits. The fund is exempt.

In the context of most real estate funds it is usually possible to identify the investors. The existence of money laundering rules and the introduction of automatic exchange of information provisions assist in this but may not be a complete solution. For example, CRS procedures only require consideration of the immediate investor whereas it is necessary to examine the ultimate investor for the purpose of treaty access.

It is also important to note that problems accessing treaty benefits are often due to a gap between requirements of the source State and information which it is possible to provide from the State of residence. Global co-ordination of documentation requirements would assist with this.

SUGGESTION THAT THE LOB INCLUDE A DERIVATIVE BENEFIT RULE APPLICABLE TO CERTAIN NON-CIV FUNDS

Questions related to certain aspects of the proposal

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

As discussed in the introduction and in our answers to questions 1 – 3, a non-CIV should be a fund which is not a CIV (as defined in the OECD's 2010 report).

Questions related to the identification of the investors in a non-CIV

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

A closed-ended real estate fund typically has a fixed life and a stable investor base. In comparison, an open-ended real estate fund is typically long-term in nature and so has a higher frequency of changes in investors.

Question 14: How would the proposal address the concern, expressed by some commentators, that many non-CIV funds would be unable to determine who their ultimate beneficial owners are and, therefore, would not know the treaty residence and tax status of these beneficial owners?

For real estate funds, it should be possible to identify the ultimate investors. Treaty eligibility on the basis of investor eligibility would seem a good option, although dealing with this from an administrative point of view would need careful consideration.

However, we support the LOB including a derivative benefit rule. This would be a pragmatic option and significantly ease the burden on the fund manager. If there were a need to identify and assess the status of every single investor for treaty access, being unable to gather this information for a single investor would adversely affect all investors in the fund.

In practice problems accessing treaty benefits are often due to a gap between requirements of the source State and information which it is possible to provide from the State of residence. Global co-ordination of documentation requirements and/ guidance would assist with this.

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

Almost all, if not all, treaties give taxing rights over income from real estate to the state in which the real estate is situated. This means that tax is levied at the fund level for a real estate fund, so non-taxation of intermediaries is not a particular concern.