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By Electronic Mail

Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development
2, rue André Pascal, 75775 Paris Cedex 16

Dear Sirs/Mesdames:

Re: BEPS Action 6 – Discussion Draft on non-CIV examples

Osler, Hoskin & Harcourt LLP[1] welcomes the opportunity to comment on the OECD Public Discussion Draft, "*BEPS Action 6 – Discussion Draft on non-CIV examples*" (the "**2017 non-CIV Discussion Draft**"), published on January 6, 2017, as part of the follow-up work on the interaction between the treaty provisions of the 2015 BEPS Report on Action 6, "*Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*" (the "**2015 BEPS Report**") and the treaty entitlement of non-CIV funds.

This letter responds to the OECD's request for comments on the three examples in the 2017 non-CIV Discussion Draft. (We have not repeated here the concerns previously identified in our letter dated April 22, 2016 in response to the OECD's discussion draft, "*Treaty Entitlement of Non-CIV Funds*", published on March 24, 2016 (the "**2016 non-CIV Discussion Draft**")).

We note that the 2015 BEPS Report concluded that treaty benefits should be provided to collective investment vehicles (CIVs), being widely held funds that hold a diversified investment portfolio and are subject to investor protection in the country in which they are established, in the circumstances set out in the OECD's 2010 Report, "*The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles*" (the "**2010 CIV Report**"). The 2010 CIV Report provided for a variety of alternative methods that countries could choose from to clarify the circumstances in which income earned by CIVs should be entitled to treaty benefits.

The 2015 BEPS Report also recognized the economic importance of cross-border investments by non-CIV funds (such as private equity funds and real estate funds), and the need to ensure that treaty benefits are granted where appropriate. Without concluding on the appropriate treatment for non-CIV funds, the OECD indicated that further work would

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[1] Osler, Hoskin & Harcourt LLP is a leading Canadian business law firm practising nationally and internationally from offices across Canada and in New York. Our clients include pension funds, sovereign wealth funds and the investors and managers of both CIVs and such non-CIV funds as real estate funds, private equity funds and hedge funds.

be done to ensure that new treaty provisions adequately address the treaty entitlement of various non-CIV funds. In March 2016 the OECD released the 2016 non-CIV Discussion Draft posing a number of questions for consultation.

In November 2016, the OECD released the multilateral instrument ("**MLI**") together with a detailed Explanatory Statement. The MLI is intended to allow swift implementation of a series of tax treaty measures that were contained in the 2015 BEPS Report, including the Action 6 treaty abuse "minimum standards." Unfortunately, neither the MLI nor the Explanatory Statement included any changes in response to the 2016 non-CIV Discussion Draft, nor any specific language to clarify when treaty benefits should be provided to income earned by CIV or non-CIV funds (or their respective investment entities).

The 2017 non-CIV Discussion Draft includes three examples that are intended to illustrate the application of the OECD's proposed treaty shopping minimum standards for non-CIV investors. In each example, the OECD concludes that (absent additional adverse facts) the principal purpose test ("**PPT**") ought not to apply to deny treaty benefits despite the fact that such benefits were taken into account in structuring the relevant investment.

Although the OECD has acknowledged that it is important to provide treaty benefits to CIV and non-CIV investors in "appropriate" circumstances, in our view, the OECD has not done enough to provide such investors with the certainty they need at the time investments are made. In particular, the 2017 non-CIV Discussion Draft indicates that the OECD deliberately kept the number of examples in the discussion draft low and has avoided any "controversial" examples. However, controversial examples are precisely where clarity is most needed, especially to highlight situations where countries may take differing views regarding particular fact patterns. It is important to bring potentially differing views among countries to light, rather than obscuring them. In particular, in our view the examples should attempt to more closely align with typical fact patterns that may arise (including, for example, where some (but not all) of the investors in a non-CIV would be entitled to equivalent treaty benefits).

Below are some ways in which the three examples could be modified/expanded to provide greater clarity:

- It is not clear in the three examples why certain facts are included, and whether the omission of such facts in the context of a particular investment could result in a denial of treaty benefits. This may be highlighted using the following references from the examples:
  - The reference to a "regional investment platform" and use of a "common currency" in the first example could potentially limit its utility (such as to investments in the EU). This example should be revised to remove the references to regional grouping and common currency – or it should be

clarified as to why such a regional grouping and common currency are necessary to get treaty benefits.

- The first example provides that Rco is regulated. If regulation is not necessary for treaty benefits then this should be removed. If it is necessary, what nature and level of regulation is the OECD contemplating for a holding company such as Rco?
- The first example provides that Rco pays tax in State R. Assuming treaty benefits would still apply if Rco has losses, the reference to paying tax in State R should be removed and replaced with the well-understood "liable to tax" standard used in Article 4 of the OECD model treaty.
- The second example assumes that Rco is fully debt-funded and that the relevant notes are listed on a recognized stock exchange. Would the result be different if Rco was partially equity funded, or if the notes were not listed?[2] Is it sufficient for the notes to be widely held?
- The third example refers to investments in a specific geographic area. Similar to the comment above on the first example, the reference to a specific geographic area should be removed – or the example should be clarified as to why such a geographic area is necessary to get treaty benefits.
- The third example provides that the fund manager is regulated. If regulation is not necessary for treaty benefits then this should be removed.

- Each of the three examples refer to investments being "driven" or "mainly driven" by certain commercial factors. However, the examples do not provide any guidance on the manner in which to distinguish between factors that "drive" or "mainly drive" an investment from those which are "one of the principal purposes" or "mere considerations" in making an investment. As a practical matter, investors would likely take into account all of the factors listed in the examples together with other factors (including the anticipated tax consequences). The examples should be modified to remove the "driven" or "mainly driven" references – or should be clarified to indicate the difference between a "driving" factor and a "principal purpose" or mere "consideration".
- The second and third examples assume that all of the investors would have been entitled to equivalent treaty benefits. To assist in the usefulness of these examples, they should be revised to discuss whether the PPT would apply if some (but not all) of the investors would be entitled to equivalent treaty benefits.

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[2] In North America, at least, it is highly unusual for notes of a securitisation vehicle to be listed on a stock exchange and we recommend the removal of this fact.

- It is questionable whether the first example provides any meaningful comfort for countries that choose to adopt both the PPT and the simplified limitation on benefits ("**LOB**") rules in the MLI. Specifically, since Fund is not entitled to as low a treaty rate of State S withholding tax as Rco, Fund would not be an "equivalent beneficiary." Accordingly, Rco (which is not a "qualifying person" and as a holding company cannot qualify for the active business test in the LOB) would not satisfy the LOB's derivative benefits clause – which requires that at least 75% of Rco's shares be held by equivalent beneficiaries. The first example should be clarified to confirm that, in such a situation, State S should grant relief under Article 7(12).[3]
- Each of the three examples indicate that the PPT could apply based on "additional facts and circumstances". The OECD should illustrate this by setting out specific examples of the types of additional facts and circumstances that could potentially cause the PPT to apply – particularly in situations where all of the ultimate investors would be entitled to identical treaty benefits (such as in the second and third examples).

The PPT is vague and subjective, allowing tax authorities the potential ability to deny treaty benefits in respect of practically any cross-border investment. This has prompted significant criticism. While we recognize that the OECD is unlikely to propose amendments to the wording of the PPT at this stage, the OECD should provide actionable guidance in the form of additional and modified examples to better illustrate how the PPT is intended to apply in respect of CIV and non-CIV funds and their respective investment entities. From a timing perspective, such guidance should be provided in advance of the proposed MLI signing ceremony in June 2017 – to provide investors with a clearer picture of what the impact of its signing will be on current and future investments.

The OECD appears to be of the view that countries should bilaterally negotiate the specific circumstances in which CIV and non-CIV funds should be eligible for treaty benefits. However, we note that the intent of the MLI was precisely to avoid the need for such duplicative and potentially lengthy bilateral negotiations. In addition, the absence of clear guidance from the OECD will likely result in countries interpreting the PPT in different ways (particularly with respect to collective investments) and a multiplicity of differing

[3] Where a holding company satisfies the PPT but would be denied benefits under the LOB, the taxpayer's remedy would be to seek relief under Article 7(12) of the MLI, which allows the competent authority of State S to grant treaty benefits that would otherwise be denied under the LOB. However, Article 7(12) relief is only available if the taxpayer can demonstrate "to the satisfaction of such competent authority that neither its establishment, acquisition or maintenance, nor the conduct of its operations, had as one of its principal purposes the obtaining of benefits under the Covered Tax Agreement." The OECD should clarify that Article 7(12) may apply in a situation like this – despite the fact that Article 7(12), unlike the PPT, does not specifically exclude tax motivated transactions that are in accordance with the object and purpose of the relevant provisions of the convention.

rules. In our view, the OECD should provide countries with clear guidance and a specific menu of options (similar to the approach followed in other areas within the MLI) to clarify the circumstances in which treaty benefits are intended to apply to CIV and non-CIV funds.

The following is a non-exhaustive list of potential options that countries could use to clarify when treaty benefits should apply:

- Countries could agree on a presumption that the PPT would not apply if at least 75% of the ultimate investors in a CIV or non-CIV fund would have been entitled to the same or similar treaty benefits had they not invested on a collective basis.
    - The use of a 75% threshold would allow consistency between the PPT rule and the proposed derivative benefits rule under the MLI's simplified LOB approach.
    - The presumption could be rebutted, for example, where a particular treaty provision is misused or abused (such as through the splitting of contracts to avoid a 12 month "permanent establishment" rule).
- Countries could grant treaty benefits to regulated and/or widely-held CIV and non-CIV funds.
- Countries could allow a proportionate amount of treaty benefits – determined by looking through a particular CIV or non-CIV fund (or their investment entities) to determine the extent to which the ultimate investors would be entitled to the same or similar treaty benefits.
- Countries could allow CIV and non-CIV funds to reorganize (on a tax-free basis) during the period of time between when the MLI is signed and when it comes into effect. This option would recognize the fact that investment decisions have been made based on existing treaty rules – and put existing investors in a comparable position to new investors.[4] (By analogy, this is similar to the approach followed by Canada when new rules were introduced for income trusts).
- Countries could allow existing treaty rules to continue to apply to gains that accrue prior to the MLI changes coming into effect. Again, this would recognize the fact that investment decisions have been made based on existing treaty rules – and put existing investors in a comparable position to new investors. (By analogy, this is similar to the approach followed by Canada when rules were introduced in 1972 to tax capital gains).

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[4] This approach would avoid situations similar to the turmoil created in the Eurobond markets in the 1980's when the United States terminated its tax treaty with the Netherlands Antilles without sufficient transition relief (despite having previously issued Revenue Rulings that recognized investors in third countries were investing through residents of the Netherlands Antilles).

- Countries that agree to adopt both the MLI's PPT and the simplified LOB rules could clarify the circumstances in which those rules are intended to interact, and should consider modifying Article 7(12) to make it consistent with the PPT. Specifically, even if one of the principal purposes of the establishment, acquisition or maintenance of the treaty resident, or the conduct of its operations, is to obtain treaty benefits, countries should agree that relief under Article 7(12) will be available if the granting of such benefits would be in accordance with the object and purpose of the relevant provisions of the applicable treaty.

Finally, we note that the OECD could also link its Action 6 minimum standards with its recommendations on Action 14 (Making Dispute Resolution Mechanisms More Effective). This could be done, for example, through the use of a pre-ruling mechanism that would allow private equity or other collective investors to determine, on an expedited basis and in advance of an investment, whether treaty benefits will apply to a particular investment.

If you have questions or would like further information regarding any of the points discussed above, please contact Patrick Marley (pmarley@osler.com) and/or Matias Milet (mmilet@osler.com).

Yours very truly,

Osler, Hoskin & Harcourt LLP