EUROPEAN ASSOCIATION FOR INVESTORS
IN NON-LISTED REAL ESTATE VEHICLES

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OECD COMMITTEE ON FISCAL AFFAIRS
TAX TREATIES, TRANSFER PRICING AND FINANCIAL TRANSACTIONS
DIVISIONS, OECD/CTPA

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INREV

Letter

SUBJECT
INREV response to OECD Discussion Draft BEPS Action 6: preventing the granting of treaty benefits in inappropriate circumstances

DATE
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CHAMBER OF COMMERCE
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Dear Committee on Fiscal Affairs,

Please find attached INREV's response to OECD discussion draft BEPS Action 6: preventing the granting of treaty benefits in inappropriate circumstances, dated 14 March 2014.

We hope to provide a meaningful contribution to your work to support the development of a sound regulatory framework and remain available should you have any specific questions about the non-listed real estate fund industry.

Kind regards,

Matthias Thomas
Chief Executive INREV

Attachment:
- INREV response to OECD discussion draft BEPS Action 6: preventing the granting of treaty benefits in inappropriate circumstances, dated 14 March 2014

Submitted via email: taxtreaties@oecd.org

INREV comment on OECD Discussion Draft relating to Treaty Abuse (BEPS Action 6)

About INREV

INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance and information related to the development and harmonisation of professional standards, reporting guidelines and corporate governance within the non-listed property funds industry across Europe. In addition, INREV undertakes research and surveys of the industry and constructs the INREV Index which covers the performance of institutional non-listed real estate funds investing in Europe.

INREV currently has 352 members. Our member base includes institutional investors from around the globe as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into the non-listed real estate funds industry.

Our fund manager members manage 461 European non-listed real estate investment funds with a combined Gross Asset Value of EUR 274.1 billion, as well as joint ventures, club deals and separate accounts for institutional investors. INREV's members represent almost all jurisdictions of the European Union's internal market and a range of underlying long-term investment vehicle structures that support European economic stability, job creation and growth.

Concerns regarding the Discussion Draft on Treaty Abuse

INREV shares the concerns of the G20 and 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. INREV also supports a coordinated and comprehensive international approach to tackle these important issues.

However, the discussion draft has proposed measures that could inadvertently have a significant negative impact on institutional real estate investment and related sectors such as infrastructure that generally use the same or very similar investment fund structures, which are critical for economic stability, job creation and growth.

INREV is of the view that the Abuse Draft contains a number of anti-abuse rules that as applied may harm the main objective of tax treaties, which is the avoidance of double taxation. If implemented on a global scale, the proposed anti-abuse rules may severely impact genuine and bonafide cross border investments.

More specifically, INREV in concerned that the likely impact on collective investment vehicles (**"CIVs"**) is not being adequately considered in the BEPS Action Plan and the subsequent Abuse Draft. If implemented, the proposed main abuse concepts (LOB and Main Purpose tests) would disallow treaty access to many CIVs used in the real estate investment industry. Many of these CIVs will simply not pass the proposed LOB-test.

This result will not only apply to European property investment funds, but may likewise apply to CIVs investing in, for example, infrastructure companies, life science enterprises, high tech and renewable energy projects, etc. In other words, the Abuse Draft is likely to affect many European funds that invest cross border. As a result, the additional tax burden of investing via CIVs may substantially

increase. This would clearly bring us further away from the policy objective - adopted by the OECD Council - of tax neutrality between direct investments and investments via a CIV[1].

INREV fears that institutional investors, especially domestically tax exempt investors such as pension funds, could favour domestic property investments, rather than international investments, if the additional tax burden associated with cross border investing becomes too high.

Hence, the recommendations in the Abuse Draft may well give rise to a substantial reduction in the cross border investments of institutional investors which are critical for supplying the capital needed to fund investment in European real assets. The application of the Abuse Draft would also be a setback for the aim of creating a level playing field within the EU internal market. For this reason INREV also believes that the proposed abuse rules - individually and as a whole - will violate European economic freedoms.

INREV urges that more attention be focused on the position of cross border property and similar investment funds, such as infrastructure, before the work on the Abuse Draft is taken further. INREV suggests that the OECD align the Abuse Draft with its work on providing CIVs with treaty benefits in order to achieve the policy objective of tax neutrality for CIVs.

Specific Suggested Points of Focus

Reference is made to the 2010 OECD Report on the treatment of collective investment vehicles (hereinafter: **"the CIV Report"**) and the Commentary to article 1 of the OECD Model Convention entitled the Application of the Convention to CIVs. The policy objective is to achieve tax neutrality between direct investment versus investment via a CIV. The CTPA has made several proposals to grant treaty benefits to CIVs in their own right as it recognises that treaty benefits may not be granted to the investors in a CIV on a transparent or look through basis in practise.

A large number of INREV members are large institutional investors such as pension funds, sovereign wealth funds, charities and insurance companies that invest via funds in a portfolio of real estate situated in various countries in order to diversify their investment portfolios while funding their long-term obligations. These investors are either subject to corporate income tax in their country of residence (insurance companies), or are by nature exempt (pension funds) but regularly pay pension benefits that are fully subject to tax in the hands of the recipients of the payments (retired workers).

On the basis of the proposed LOB-test (page 5 of the Abuse Draft), the typical investment vehicle of a European property fund would not be considered to be a "qualified person". This is because the (beneficial) interests in the given investment vehicle are - in brief - often not owned by more than 50% by persons that are resident in the country where the investment vehicle is resident.

Moreover, it is uncertain whether an investment vehicle would pass the "substantial business test" and the business of making investments for its own account could well be excluded as a qualifying activity, based on paragraph 3,a) of article X of the proposed LOB clause. Even if it is decided to include a so-called "derivative benefits test", there would still be uncertainty in many cases regarding the circumstances under which an investment vehicle would qualify.

It is still unclear how the "main purpose test" would work for a typical European property investment fund. The Abuse Draft states that "[t]o determine whether or not one of the main purposes of any person concerned with an arrangement or transaction is to obtain benefits under the Convention [a

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[1] The granting of treaty benefits with respect to the income of collective investment vehicles, public discussion draft dated 9 December 2009 to 31 January 2010, released by the CFA-OECD (2010) and the Commentary to the OECD Model Convention regarding CIVs.

tax treaty], it is important to undertake *an objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place or being a party to it".*

In combination with the recommendation to confirm that a tax treaty will not prevent a state from applying its domestic anti-abuse rules, INREV fears that many countries may take the position that a typical fund investment vehicle is not entitled to treaty benefits, as not all of the investors in a given fund would be entitled to (the same) treaty benefits, had they invested directly.

The provision of Clause X, 2., d) under iii) is too narrowly defined to provide benefits to the vast majority of CIVs, as this clause is only helps investment vehicles that are substantially held by pension funds.

No access to tax treaties could mean that property investment funds will be faced with a significant degree of uncertainty for a prolonged period of time. There will be inconsistency across jurisdictions because countries may apply the standards differently. The risk for property investment funds is liability to high withholding taxes on the repatriation of property income from the source states. Such withholding tax will not be creditable at the level of the fund, as investment funds are in general providing for a tax neutral regime.

Moreover, a transparent tax treatment whereby the underlying withholding tax can be credited at the level of the investors in the fund will, in most cases, not be possible and is, in practice, not a realistic option for tax treaty application (see also the CIV Report and the Commentary on article 1 of the OECD Model Convention, paras.6.8 to 6.34 on this issue). The result is that – in the absence of treaty benefits - there will be "triple taxation": the property income is subject to corporate income tax in the source state, repatriation to the investment fund / vehicle will be subject to withholding tax in most cases and the income will be subject to tax in the hands of the investors (either on a real time basis or when distributed).

European property investment funds are not in the business of treaty shopping. The primary purpose of a CIV is a business purpose: pooling of capital to make investments. As mentioned in the Commentary to article 1 of the OECD Model Convention: treaty abuse implies that there is <u>initiative</u> and <u>control</u> (para. 6.32) and that a CIV cannot be seen to be used effectively for "treaty shopping" if the investors do not have control (which they typically do not have). Therefore, most European property investment funds cannot be considered to make deliberately use of "treaty benefits in inappropriate circumstances". On the contrary, the use of treaty relief is crucial in order to avoid triple taxation in otherwise genuine bona fide investment structures.

Nevertheless, introduction of the Abuse Draft as it is proposed would deny treaty benefits to many CIVs and may have severe adverse consequences on the role that institutional capital plays in a globalised economy. INREV urges that the critical economic role played by real estate CIVs in supporting long-term investment in the European economy that supports economic stability, job creation and growth be considered in the development of the Abuse Draft.

INREV urges the OECD to support a more specific anti-abuse system that is not unnecessarily burdensome for CIVs. This could be achieved by recommending that the objective of avoiding double taxation prevail over the objective of combatting tax avoidance when a CIV is controlled by parties that would be eligible for tax treaty benefits if had they invested directly. See also the observations in the CIV Report.

INREV further suggests aligning the recommendations in the Abuse Draft with those developed in the CIV Report (and implemented in the Commentary). One approach could be to recommend including CIVs in the LOB as "qualified persons", provided certain conditions are met.

In this respect, we would like to remind the CTPA of the following suggestion in the CIV Report, (paragraph 55) on a specific anti-abuse concept for CIVs:

In the case of CIVs, an anti-treaty shopping provision generally would seek to determine whether a CIV is being used for treaty shopping by determining whether the owners, or a specific proportion of the owners, of interests in the CIV are residents of the Contracting State in which the CIV is organised or, in some cases, whether the owners of interests in the CIV would have been entitled to equivalent benefits had they invested directly. The latter approach would help to ensure that investors who would have been entitled to benefits with respect to income derived from the source State had they received the income directly are not put in a worse position by investing through a CIV located in a third country. The approach thus serves the goals of neutrality as between direct investments and investments through a CIV. It also decreases the risk of double taxation as between the source State and the State of residence of the investor, to the extent that there is a tax treaty between them.

Such a specific "equivalent beneficiary" approach could easily be included in the proposed LOB-clause. The general rule in the proposed LOB-clause that an entity is more than 50% controlled *by residents of one of the two treaty states* is far too restrictive and ignores the globalisation of the investment management industry. INREV strongly believes that an equivalent beneficiary clause for CIVs is not unnecessarily restrictive.

A balanced solution for CIVs could be to broaden the proposed LOB provision, Clause X, 2., d) under iii), to include "persons" that are: (i) substantially owned by pension funds, Sovereign Wealth Funds, REITs, or other taxable investors, and; (ii) are not "controlled" (>50%) by persons that would not have been entitled to similar treaty benefits, had they invested directly in the source country.

INREV believes that such a clause is fully in line with the recommendations made by the OECD in the CIV Report. Also intermediate entities owned by such a "qualified CIV" should be eligible for treaty benefits. If such clause is adopted, there would be no need for a "main purpose test" to be applied to CIVs. A CIV that has the adequate equivalent beneficiaries is – by definition – not making inappropriate use of tax treaty benefits.