European Association for Investors
in Non-Listed Real Estate Vehicles

INREV

TAX TREATIES, TRANSFER PRICING AND FINANCIAL
TRANSACTIONS DIVISION, OECD/CTPA

Date: 22 April 2016

Subject: INREV's response to OECD's "Public Discussion Draft Treaty Entitlement of Non-CIV Funds"

Dear Sirs,

Please find attached INREV's response to OECD's "Public Discussion Draft: Treaty Entitlement of Non-CIV Funds", dated 24 March 2016.

We hope again 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's response to OECD's "Public Discussion Draft Treaty Entitlement of Non-CIV Funds, 24 March 2016"

Submitted via email: taxtreaties@oecd.org

Gustav Mahlerplein 62, 1082 MA Amsterdam, The Netherlands
info@inrev.org | www.inrev.org

INREV

About INREV: the voice of the European non-listed real estate investment industry

INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance, research and information related to the development and harmonization of professional standards, reporting guidelines and corporate governance within the non-listed property funds industry across Europe.

INREV currently has 383 members. Our member base includes institutional investors from around the globe including pension funds, insurance companies and sovereign wealth funds, as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into non-listed real estate vehicles in Europe.

Our fund manager members manage more than 500 European non-listed real estate investment funds, 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, such as Joint Ventures, Club-Deals, Non-CIVs and other non-listed real estate investment vehicles, the vast majority of which are Alternative Investment Funds ("AIFs") subject to regulation under the European Alternative Investment Fund Directive ("AIFMD").

Comments regarding the Discussion Draft on Treaty Entitlement of Non-CIVs

INREV welcomes the opportunity to comment on the recent OECD Public Discussion Draft: Treaty Entitlement of Non-CIV Funds (the "Public Discussion Draft"). We are very pleased that the OECD seeks the view of the stakeholders in the investment management industry in order to find appropriate solutions non-CIVs in connection with the work on BEPS Action 6 – Treaty Abuse. In paragraph 4 of the Introduction of the Public Discussion Draft two main concerns about granting tax benefits with respect to non-CIV funds are stated:

(i) Non-CIV funds may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits, and

(ii) Investors may defer recognition of income on which treaty benefits have been granted.

In order to find ways to address these concerns the Public Discussion Draft raises a number of specific questions.

In this document INREV will address the concerns raised and answer the questions as far as they are relevant in the context of real estate non-CIV funds. INREV believes that the concerns raised in relation to granting treaty benefits to non-CIV funds are not relevant to non-CIV real estate funds due to the specific tax treatment of real estate investments under the tax laws of the source state which is supported by article 6 of the OECD Model Tax Convention on Income and Capital (Model Treaty). Therefore, and as further elaborated below, INREV believes that a specific carve-out for non-CIV real estate funds is justified and that such funds should pass the PPT test.

No treaty abuse and tax deferral in the case of non-CIV real estate funds

INREV would like to emphasise the purpose and the unique tax position of non-CIVs investing in real estate ("Real Estate Non-CIVs"). As explained further below, Real Estate Non-CIVs cannot be used to provide treaty benefits to investors to which they are otherwise not entitled and/or to defer income.

INREV

The primary commercial purpose of Real Estate Non-CIVs is to enable collective investment in real estate assets for the account of multiple investors. As we have stated in previous submissions[1], we believe that BEPS Action 6 should put investors in Real Estate Non-CIVs in the same tax position that they would be in if they had invested in the underlying real estate assets directly. We emphasise that this goal is in line with the policy defined by the OECD in the 2010 CIV report. In other words, there should be tax neutrality between a direct investment in real estate and an investment in real estate via a non-listed real estate vehicle including a Real Estate Non-CIV.

Income derived from a direct investment in real estate is generally taxed at the level of the investor owning the real estate asset through imposition of (corporate) income tax. However, countries where the real estate assets are located typically do not impose other taxes on this income. As a result, there is generally no difference in the tax treatment of an investor that invests in real estate in its home state and an investor that invests in real estate in another state. To avoid double taxation, the investor's home state exempts this income earned on real estate in another state from (corporate) income tax in accordance with article 6 of the Model Treaty. In contrast to income from other asset classes, the Model Treaty does not restrict source states in their right to levy tax on real estate income – see also section 6 and section 13(4) of the Model Treaty.

Pooling real estate investments through a Real Estate Non-CIV does not limit the right of the source state to levy (corporate) income tax. The only consequence of interposing a Real Estate Non-CIV is that the source state exercises its taxing right at the level of the Real Estate Non-CIV (or a subsidiary of such Real Estate Non-CIV), rather than at the level of the investor.

We note that this method of taxation of real estate income forms a significant difference with other types of income such as dividends, interest or royalties, as these types of income typically are subject to a withholding tax levied by the source state.

Following this significant difference in the tax treatment of income derived from real estate, it cannot be said that Non-CIVs investing in real estate "*may be used to provide treaty benefits to investors that are not themselves entitled to the same treaty benefits*". Therefore one of the main concerns underpinning BEPS Action 6, which is that Non-CIV funds may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits, does not apply to Real Estate Non-CIVs.

Despite this fact, treaty access is still important for the appropriate functioning of Real Estate Non-CIVs. This can be explained by the fact that a Real Estate Non-CIV generally holds its real estate investments through one or more (controlled) special purpose companies. The primary role of these special purpose companies is generally to ensure isolation of the liabilities of and potential legal claims against each asset or relatively small group of assets. Especially real estate investments that are

---

[1] INREV response to OECD Discussion Draft "BEPS Action 6: preventing the granting of treaty benefits in inappropriate circumstances", dated 14 March 2014; INREV response to OECD Public Discussion Draft "Follow Up Work on BEPS Action 6: Preventing Treaty Abuse", dated 21 November 2014; and INREV response to OECD "Revised Discussion Draft BEPS Action 6: Prevent Treaty Abuse", 22 May 2015.

financed with external debt need to be ring-fenced because of the potential liabilities relating to the external financing arrangements.

To secure the tax neutrality of Real Estate Non-CIVs, it is important that the interposition of such special purpose companies does not cause an additional tax burden that would not arise if the investments were held directly. In this sense, the application of tax treaties is crucial for achieving tax neutrality for Real Estate Non-CIVs as a whole – i.e. including their (controlled) special purpose companies.

In addition, with regard to the second main concern underpinning BEPS Action 6 proposals, that investors may use Non-CIVs to defer recognition of income, we emphasise that Real Estate Non-CIVs cannot be used for the deferral of taxation. This point is clear because, as noted above, source states secure the immediate taxation of real estate income pursuant to their taxing rights under the Model Treaty.

Conclusion

INREV believes that neither treaty shopping nor tax deferral is the purpose of a Real Estate Non-CIV, given the unique tax profile of real estate as described above. Further, INREV believes that unrestricted access to tax treaties for Real Estate Non-CIVs and their (controlled) special purpose companies is justified in order to achieve tax neutrality consistent with the OECD 2010 CIV report.

Suggestions related to the LOB provisions

INREV recommends that treaty benefits be granted to Non-CIVs (including its directly or indirectly wholly owned entities established in the same jurisdiction) that fulfil the following cumulative conditions:

a) More than 50% of the value of the Non-CIV shares is derived directly or indirectly from immovable property (real estate) that is held by the Non-CIV or directly or indirectly controlled entities of the Non-CIV (n.b., this wording follows article 13(4) of the OECD Model Tax Convention on Income and Capital); and

b) At least 80% of the shares in the Non-CIV are held by professional (non-individual) investors such as insurance companies, pension funds, sovereign wealth funds, non-profit organisations, other Non-CIVs qualifying as Real Estate Non-CIVs, and their controlled entities.

INREV has the following comments to the questions relating to the *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?

As explained above, a Real Estate Non-CIV cannot be used to further treaty abuse. The widely held requirement should not apply to Real Estate Non-CIVs.

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)?

We do not consider that regulation should be a condition for treaty access. In particular, it is not clear how the regulatory requirements identified in the question would provide any protection against treaty abuse or tax deferral; and as such, we do not recommend that regulatory criteria should be introduced.

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?

As explained above, a Real Estate Non-CIV cannot be used to further treaty abuse. The concerns regarding treaty shopping should not apply to Real Estate Non-CIVs.

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?

As explained above, a Real Estate Non-CIV cannot be used for deferral of income. The proposals regarding immediate distribution of earnings should not apply to Real Estate Non-CIVs.

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?

Given the specific tax treatment of income from real estate (exclusive and unlimited taxation in source state, not restricted by tax treaties), states should not be concerned that taxation is limited to corporate income tax in source state.

INREV

Question 6: One argument that was put forward in relation to suggestions for a specific LOB exception for non-CIV funds was that it would avoid or reduce the cascading tax when investment is made through a chain of intermediaries. In practice, what is the intermediate entity-level tax, if any, that is typically payable with respect to income received from a State of source? Are there special purpose vehicles that are commonly used by funds to invest indirectly? How are intermediate entities typically funded, debt or equity? If debt, is it unrelated party financing?

Income from real estate is not subject to withholding tax. Therefore, there is no intermediary level tax if a Real Estate Non-CIV holds real estate directly. For legal and commercial reasons Real Estate Non-CIVs use special purpose vehicles in the form of limited liability companies to hold real estate assets. These special purpose entities are typically funded with a mix of equity, third party debt and related party debt.

INREV has the following comments to the questions relating to the *suggestion that the LOB include a derivative benefit rule applicable to certain Non-CIV funds*:

Question 8: The rationale that was given for the above proposal refers to the fact that "investors in Alternative Funds are primarily institutional investors, and are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund". What is the meaning of "institutional investors" in that context? In particular, does it include taxable entities or other non-CIVs? Absent a clear definition of "institutional investors", how can it be concluded that institutional investors "are often entitled to benefits that are at least as good as the benefits that might be claimed by the Alternative Fund"? Also, is it suggested that "institutional investors" are less likely to engage in treaty-shopping and, if yes, why?

The principal purpose of Non-CIV funds, like collective investment vehicles generally, is to allow investors to pool capital and gain efficient access to professional management and diverse assets. Access to treaty benefits is not a principal purpose of Non-CIV funds, although treaty benefits may be necessary to prevent investors from suffering an additional layer of tax due to their investment through a Non-CIV fund. Obtaining tax neutrality is a consequence of the investment and not a main purpose of it, and is not to be regarded as treaty shopping.

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?

A Non-CIV fund would be, in the absence of further definition, any collective investment scheme which is not a CIV. CIVs are defined as "funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection legislation in the country in which they are established." Non-CIV funds would therefore cover a spectrum from fully regulated funds that do not qualify as CIVs only because they invest wholly or to some extent in investments other than securities, to alternative investment funds for "professional" or "sophisticated" investors, which do not require the same levels of investor regulation. These Non-CIV funds may be open-ended or closed-ended (with or without a fixed life), they may be companies, partnerships or other entities in legal form, and they may be tax transparent or not.

INREV has the following comments to the *suggestion of a "global streamed fund" regime*:

Question 24: Although the above proposal for a "Global Streamed Fund" regime is very recent and has not yet been examined by Working Party 1, the Working Party wishes to invite commentators to offer their views on its different features. In particular, the Working Party invites comments on:

- **i) Whether the approach would create difficulties for non-CIV funds that do not currently distribute all their income on a current basis?**
- **ii) Whether the approach would create difficulties for non-CIV funds that cannot, for various reasons, determine who their investors are?**
- **iii) Whether the suggestion that tax on distributions be collected by the State of residence and remitted to the State of source would create legal and practical difficulties?**
- **iv) What should be the consequences if, after a payment is made to a GSF, it is subsequently discovered that the fund did not meet the requirements for qualifying as a GSF or did not distribute 100% of its income on a current basis?**

As explained above, a Real Estate Non-CIV cannot be used to further treaty abuse. Therefore, a global streamed fund, if adopted, should not apply to Real Estate Non-CIVs.

INREV has the following comments to the *concerns related to the PPT rule*:

Question 25: Commentators wishing to suggest new examples related to the application of the PPT rule to common types of legitimate arrangements that are commonly entered into by non-CIV funds are invited to do so. These examples should be brief and should focus on common transactions that do not raise concerns related to treaty-shopping or inappropriate granting of treaty benefits.

INREV strongly believes that treaty shopping and /or tax deferral is not the purpose of a Real Estate Non-CIVs. Our opinion is based on the fact that real estate income is not subject to withholding tax; however it is subject to (corporate) income tax in the source state. As such, (corporate) income tax is levied immediately upon generation of the income and tax is also not deferred. We recommend adding Real Estate Non-CIVs that fulfil the following requirements as an example of a legitimate arrangement:

a) More than 50% of the value of the Non-CIV shares is derived directly or indirectly from immovable property (real estate) that is held by the Non-CIV or directly or indirectly controlled entities of the Non-CIV (n.b., this wording follows article 13(4) of the OECD Model Tax Convention on Income and Capital); and

b) At least 80% of the shares in the Non-CIV are held by professional (non-individual) investors such as insurance companies, pension funds, sovereign wealth funds, non-profit organisations, other non-CIVs qualifying as Real Estate Non-CIVs, and their controlled subsidiaries.