The Organisation for Economic Cooperation and Development (OECD) launched an Action Plan with 15 points aiming to develop solutions to fight BEPS and ensure that profits are taxed where economic activities generating the profits are performed and where value is created.

In particular the work on the prevention of granting treaty benefits in inappropriate circumstances, may impact, deliberately or inadvertently, collective investments vehicles (CIVs), including cross-border real estate funds, which might also suffer collateral damages.

RISK OF DOUBLE OR TRIPLE TAXATION OF CIVS IS STILL LOOMING

In March 2014, a discussion draft on the inappropriate use of tax treaties was released which raised strong reactions and was a source of significant concern for the representatives of the various fund industries, including INREV. It proposed the inclusion of a specific anti-abuse rule based on the limitation-on-benefits provisions (the “LOB Clause”) included in treaties concluded by the United States. Based on the tests included in the March 2014 draft, many of the CIVs would have never been able to pass any of the proposed LOB tests. Therefore, CIVs would, in most cases, not have been granted treaty benefits. Disallowing property investment funds from treaty access would possibly result in substantial double (or triple) taxation. This would be detrimental for funds distributed or operating on a cross-border basis. The discussion draft also suggested including an additional more general anti-abuse rule based on the principal purposes of transactions or arrangements (the principal purposes test or “PPT” rule).

Fortunately, taking into account the various comments received by the fund industry, the OECD has now expressly recognised these concerns in the final report released in September. It is stated that policy considerations will be addressed to make sure that the proposals do not unduly impact CIVs in cases where countries do not intend to deprive them of treaty benefits and suggested several alternative provisions to deal adequately with the situation of CIVs. However, the report further states that additional work is needed with respect to the policy considerations relevant to treaty entitlement of CIVs and non-CIV-funds.
EXPECTED TRENDS IN THE REAL ESTATE INDUSTRY

Although it is too early to fully understand all the possible implication of BEPS for real estate funds, two main trends can nevertheless be anticipated regarding real estate fund structuring in the years to come.

TREND 1. CONSOLIDATION OF THE MANAGEMENT FUNCTIONS WITHIN THE SAME COUNTRY

- The first trend is that fund managers will need to consider the consolidation of their management functions within the same country and be attentive to matters such as the use of intermediate holding and financing companies (SPVs). They will also need to consider the need to secure treaty access, which will ultimately imply having an adequate level of substance consistent with the allocation of functions, risks and assets within the fund structure.

TREND 2. REVIEW OF EXISTING FINANCING AND MANAGEMENT FEE STRUCTURES

- The second expected trend is that real estate funds will likely have to review their existing financing and management fee structures in order to take into account the upcoming new transfer pricing regulations. Also, having adequate documentation substantiating cross-border intra-group transactions will become more and more crucial.

There is no doubt that some of the various proposed anti-treaty abuse provisions (in particular the LOB Clause) will be a mandatory element of the final BEPS recommendations, while the treatment of CIVs will be left to the discretion of the various countries that will include the guidelines in their tax treaties. The risk of CIVs being “kicked out” of the tax treaty network is, therefore, still imminent.

MORE UNCERTAINTY AND MORE ADMINISTRATIVE BURDEN

Treaty application and reporting issues for CIVs could get more and more complex and uncertain. It will also undoubtedly increase the administrative and compliance burdens for real estate funds wanting to secure treaty benefits.

OTHER EXPECTED IMPACTS FOR CROSS-BORDER REAL ESTATE FUNDS

There is another situation which has apparently not been addressed by the OECD in its report but which is relevant for non-listed property fund structures. The OECD does not clarify the situation regarding lower-tier holding SPVs which hold a foreign property SPV. These lower tier holding SPVs would in practice be the entities claiming treaty benefits, rather than the CIV. It could be that the OECD would consider that the CIV outcome applies equally to the CIV-controlled SPVs.

All real estate funds must closely monitor the expected tax related changes that will occur at international or local levels during the coming years, as they will inevitably have an impact on fund structuring. INREV, joined by ten real estate industry associations, will continue to use the public consultation period and file comments with the OECD on its upcoming recommendations. It can therefore be expected that INREV will seek additional input from the industry in order to clarify further the situation of real estate funds.

ADDITIONAL AREAS THAT HAVE TO BE CAREFULLY MONITORED

Based on the reports which have just been released by the OECD and on the work that is currently ongoing at OECD level, the following areas must be carefully monitored by the industry:

- Intra-group debt funding
- Hybrid instruments and entities
- Transfer pricing rules
- Documentation and reporting requirements
- Anti-avoidance rules and treaty access
- Exchange of information

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