Tax Treaties,
Transfer Pricing and Financial Transactions Division
OECD/CTPA

By email: taxtreaties@OECD.org

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Dear Sirs

BEPS Action 6: discussion draft on non-CIV examples

I am writing on behalf of BVCA to comment on the examples in the public discussion draft.

The BVCA is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of almost 600 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. Our members have invested over £27 billion in nearly 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 385,000 people and 84% of UK investments in 2015 were directed at small and medium-sized businesses.

We welcome the decision of Working Party 1 to include examples in the commentary on the PPT rule illustrating the application of the PPT rule to non-CIV funds and the opportunity to comment on the examples in the public discussion draft.

Introductory text; status of the examples

Whilst we acknowledge that it is difficult to convey the diversity and complexity of non-CIVs and their structures through a series of examples, examples 1 – 3 have relatively simple facts and are unlikely to be instructive in most common commercial circumstances. In addition, there is a risk that, as drafted, the examples could be interpreted narrowly by tax authorities with the result that treaty benefits may be denied unless a particular structure is effectively identical to the circumstances set out in the examples. Accordingly, it is very important that the commentary makes it crystal clear that these examples are vehicles for the discussion of factors which are relevant to the process of applying the PPT in any given set of circumstances and are not "templates" which require taxpayers to identify with particular features of the fact pattern in each example. We would suggest including some introductory text along the lines of the following:

> "The following three examples illustrate how the PPT rule might be applied in circumstances involving non-CIV funds. They are designed to illustrate the careful process required in any given situation of analysing and balancing the relative value and importance of treaty benefits against other non-tax functions and benefits. Each situation needs to be examined on its own merits, and the examples are not templates of the only fact patterns where the PPT will not prevent treaty benefits being obtained, nor are they designed to provide a comprehensive list of all the relevant factors."

Although the examples are no more than that, they should be as realistic and helpful to the resolution of real life situations as possible. Our comments below are designed to help with that. We have confined our comments to examples 1 and 3, with particular focus upon example 1.

Example 1

Example 1 appears to address the position of a company which is a wholly owned subsidiary of a single institutional investor. That is a relatively uncommon situation, and certainly not a fact-pattern helpful to the majority of non-CIV funds. It also assumes that the fund is resident in a particular state (whereas in many cases non-CIV funds will be tax transparent entities which are not resident in particular state) and also that the fund is subject to regulation, whereas in many cases it is the fund manager which is regulated rather than the fund. We would suggest that the opening text is amended to read:

> "RCo, a company resident of State R, is a wholly owned subsidiary of a fund with a diverse investor base. The fund is established under the laws of State T where it is regarded as tax transparent (and so not a tax resident of State T). The fund is operated by a professional fund manager based in State T. The fund (or its manager) is regulated if required under local law in State T".

References to RCo operating as a "regional investment platform" and a common currency are unhelpful as an entity in the position of RCo may hold investments with a wide geographic spread not restricted to a particular externally identifiable political "region". Even within the EU there is currently more than one currency in common circulation. The inclusion in the example of those words might be taken to suggest that a company in the position of RCo could only invest in companies based in Eurozone countries and could not make investments in EU countries which are not members of the Eurozone or in countries on the periphery of the EU such as Norway, Switzerland and, in due course, the United Kingdom. We would suggest that the word "regional" (in line 3), "located in countries in a regional grouping that includes State R" and the words "State R's membership of a regional grouping and the use of the regional grouping's common currency" (line 8) should be deleted.

We would suggest that the word "employs" (line 10) is replaced by the word "engages" to avoid the narrow implication that human resources can only be obtained through direct contracts of employment with individuals.

Finally, a fund may hold investments through more than one parallel holding company. For obvious liability limitation reasons or to make it easier to borrow from different lenders with segregated security pools, it may be preferable for a fund to spread its investments between a number of parallel (but very similarly structured) corporate vehicles rather than holding them under a single corporate entity. It would be helpful if the example could address cases where a fund operates a coherent platform though a number of parallel entities. We would suggest ending the example with words such as:

> "This conclusion would not be invalidated in a case where the fund operates a coherent investment platform in State R through a number of similarly structured entities rather than a single company."

Example 3

Turning to example 3 (immoveable property) we have assumed for the purposes of commenting on this example that there are indeed some meaningful treaty benefits to be obtained by RCo. As a general matter, we would not expect double tax treaties between State R and the states in which RCo's immoveable property investments are located to confer any particular benefits on RCo so far as the income and capital gains derived from directly held real estate investments are concerned. We would expect these items to be taxable primarily in the states in which the immoveable property investments are located. If real estate is held in intermediate holding companies based in the jurisdictions in which the immovable property is situated or a third state, then there may be some treaty benefits to be obtained by RCo. We would suggest that this point should be clarified, perhaps by referring to the fund investing in a portfolio of shares, securities and indirectly held real estate investments.

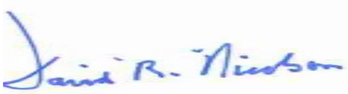
We do not think that it is realistic or helpful to users to assume that RCo does not derive any treaty benefits that are better than those to which its investors would be entitled. It is difficult to see how an example could usefully illustrate the careful balancing of tax and non-tax benefits required by the PPT rule if it proceeds on the basis that there are no tax benefits in the first place. It may be more realistic to assume that the majority (by number and value) of the fund's investors are resident in jurisdictions such that RCo does not derive any treaty benefits that are better than those to which that majority would be entitled but that RCo would (but for the operation of the PPT rule) be entitled to treaty benefits which are better than those which would be enjoyed by a significant minority (by number and value) of its investors.

As with example 1, it would be helpful if the example could address cases where a fund operates a coherent platform though a number of parallel entities.

We attach in the appendix the text of examples 1 and 3 marked-up to show our suggested changes.

If we can be of further assistance, please let us know.

Yours faithfully



David R Nicolson
Chairman of the BVCA Taxation Committee

Appendix

Immovable Property non-CIV fund example

Real Estate Fund, a State C partnership treated as fiscally transparent under the domestic tax law of State C, is established to invest in a portfolio of (directly and indirectly held) real estate investments and debts and equity securities of real estate investment holding vehicles (REITs etc) in a specific geographic area. Real Estate Fund is managed by a regulated fund manager and is marketed to institutional investors, such as pension schemes and sovereign wealth funds, on the basis of the fund's investment mandate. A range of investors resident in different jurisdictions commit funds to Real Estate Fund. The investment strategy of Real Estate Fund, which is set out in the marketing materials for the fund, is not driven by the tax positions of the investors, but is based on investing in certain real estate assets, maximising their value and realising appreciation through the disposal of the investments. Real Estate Fund's investments are made through a holding company, RCo, established in State R. RCo holds and manages all of Real Estate Fund's immovable property assets and provides debt and/or equity financing to the underlying investments. RCo is established for a number of commercial and legal reasons, such as to protect Real Estate Fund from the liabilities of and potential claims against the fund's immovable property assets, and to facilitate debt financing (including from third-party lenders) and the making, management and disposal of investments. ~~It is also established for the purposes of administering the claims for relief of withholding tax under any applicable tax treaty. This is an important function of RCo as it is administratively simpler for one company to get treaty relief rather than have each institutional investor process its own claim for relief, especially if the treaty relief to which each investor would be entitled as regards a specific item of income is a small amount.~~ After a review of possible locations, Real Estate Fund decided to establish RCo in State R. This decision was mainly driven by the political stability of State R, its regulatory and legal systems, lender and investor familiarity, access to appropriately qualified personnel and the extensive tax convention network of State R, including its treaties with other States within the specific geographic area targeted for investment. RCo~~, however, does not obtain~~obtains treaty benefits that are better than the benefits to which a significant minority (by number and value) of its investors would have been entitled if they had made the same investments directly in these States and had obtained treaty benefits under the treaties concluded by their States of residence.

In this example, whilst the decision to locate RCo in State R is taken in light of the existence of benefits under the tax conventions between State R and the States within the specific geographic area targeted for investment, it is clear that RCo's ~~immovable property~~ investments are made for commercial purposes consistent with the investment mandate of the fund. Also RCo does not derive any treaty benefits that are better than those to which a majority (in number and value) of its investors would be entitled and each State where RCo's underlying immovable property investments are made is allowed to tax the income derived directly from such investments. In the absence of other facts or circumstances showing that RCo's investments are part of an arrangement, or relate to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the tax treaties between RCo and the States in which RCo's ~~immovable property~~ investments are located.

This conclusion would not be invalidated in a case where the fund operates a coherent investment platform in State R through a number of similarly structured entities rather than a single company.

Appendix

~~Regional~~ Investment Platform example

RCo, a company resident of State R, is a wholly owned subsidiary of a fund with a diverse investor base. The fund is established under the laws of State T where it is regarded as tax transparent (and so not a tax resident of State T). The fund is operated by a professional fund manager based in State T. The fund (or its manager) is regulated if required under local law in State T~~RCo, a company resident of State R, is a wholly-owned subsidiary of a Fund, an institutional investor that is a resident of State T and that was established and is subject to regulation in State T~~. RCo operates exclusively to generate an investment return as the ~~regional~~ investment platform for Fund through the acquisition and management of a diversified portfolio of private market investments ~~located in countries in a regional grouping that includes State R~~. The decision to establish the ~~regional~~ investment platform in State R was mainly driven by the availability of directors with knowledge of ~~regional~~ relevant business practices and regulations, the existence of a skilled multilingual workforce~~, State R's membership of a regional grouping and use of the regional grouping's common currency~~ and the extensive tax convention network of State R, including its tax convention with State S, which provides for low withholding tax rates. RCo ~~employs~~ engages an experienced local management team to review investment recommendations from Fund, approve and monitor investments, carry on treasury functions, maintain RCo's books and records, and ensure compliance with regulatory requirements in States where it invests. The board of directors of RCo is appointed by Fund and is composed of a majority of State R resident directors with expertise in investment management, as well as members of Fund's global management team. RCo ~~pays~~ is subject to tax and files tax returns in State R.

RCo is now contemplating an investment in SCo, a company resident of State S. The investment in SCo would constitute only part of RCo's overall investment portfolio, which includes investments in a number of countries in addition to State S which are also members of the same regional grouping. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30 per cent to 5 per cent. Between State S and ~~State T,~~ the states where the investors in the fund are resident the applicable withholding tax rate on dividends ~~is~~ varies between ~~10~~ 5 per cent and 30 per cent.

In making its decision whether or not to invest in SCo, RCo considers the existence of a benefit under the State R-State S tax convention with respect to dividends, but this alone would not be sufficient to trigger the application of paragraph 7. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 7 applies to an investment, it is necessary to consider the context in which the investment was made, including the reasons for establishing RCo in State R and the investment functions and other activities carried out in State R. In this example, in the absence of other facts or circumstances showing that RCo's investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R-State S tax convention to RCo.

This conclusion would not be invalidated in a case where the fund operates a coherent investment platform in State R through a number of similarly structured entities rather than a single company.