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Our ref Comments to OECD - Follow up work on BEPS Action 6 Preventing treaty abuse

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9 January 2015

By email

Dear Marlies

Re: Comments on BEPS Action 6 Public Discussion Draft – Impact on Institutional Investors

Thank you for the opportunity to provide comments on the Public Discussion Draft entitled *"Follow up work on BEPS Action 6: Preventing treaty abuse"*, which was released for comment on 21 November 2014.

We act on behalf of the following Australian and New Zealand Institutional Investors:

- Queensland Investment Corporation ("QIC"); and
- New Zealand Superannuation Fund ("NZ Super").

Please refer to Appendix B for further information in respect of each of our clients participating in this joint submission.

For the purposes of this submission the following abbreviations are used:

- The OECD Report (2014 Deliverable) titled, "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances", by the OECD/G20, Base Erosion and Profit Shifting Project, will be referred to as "Action Plan 6".
- The OECD Report titled "The Granting of Treaty Benefits with respect to the income of Collective Investment Vehicles", adopted by the OECD Committee on Fiscal Affairs on 23 April 2010, will be referred to as the "CIV Report".
- The OECD Public Discussion Draft titled "Follow up work on BEPS Action 6: Preventing Treaty Abuse", dated 21 November 2014 will be referred to as the "Discussion Draft".
- The expression Government when used in this submission means either a Nation State or a political sub division of that Nation State. For example in the context of Australia the term Government will cover the Commonwealth of Australia and each State and Territory Government within Australia individually.
- Sovereign Wealth Funds are defined in this submission to cover globally recognised Government sponsored investment entities which invest funds for the benefit of the citizens of that Government as a whole rather than any individual or group within the population

administered by that Government. The term "SWF" is used as an abbreviation of Sovereign Wealth Fund. The definition of a SWF will exclude Government owned trading entities. A Government owned trading entity includes companies such as Government owned broadcasters, electricity suppliers and telecommunications companies. Investment entities are entities set up for either the purpose of meeting a future Government liability (eg pensions) or as a mechanism for intergenerational funds transfer. A broader definition is beyond the scope of this submission however reference is made to the Institutional Investor's Sovereign Wealth Centre (www.sovereignwealthcentre.com) which publishes data on all globally recognised SWFs.

- Pension Funds are defined in this submission to mean either defined benefit or defined contribution funds which are organised to provide pension benefits to either employees or contributors. However we have excluded from the definition of Pension Funds any privately sponsored fund for the benefit of a family group or that has less than 1,000 contributors who contribute on a regular basis. A broader definition is beyond the scope of this submission however reference is made to the Pensions & Investments web page, (www.pionline.com).
- Institutional Investors are defined to be either or both SWFs and Pension Funds.

1 Executive Summary

We have set out two recommended alternate approaches to appropriately deal with the position of Institutional Investors.

1.1 Preferred Position

The preferred position is to align the position of Institutional Investors to "not for profit organisations" who are "qualified persons" pursuant to sub paragraph 2(d)(i). This could be achieved by amending the definition of "qualified person" in subparagraph 2(d)(ii) by removing all the words in that subparagraph starting with the words ", provided that…" and substituting the following words "or is an investment entity owned by an entity set out in sub paragraph 2(b)".

Given the nature and functions of Institutional Investors this recommendation is as much a social and political decision as it is a matter of tax policy.

1.2 Alternate Position

Alternatively, we propose to align the position of Institutional Investors to banks and other financial institutions.

As set out in this submission some Institutional Investors are larger than the world's largest banks and by nature we consider that an Institutional Investor is more aligned with financial institutions than manufacturing or trading companies. This change requires some changes to both the wording of sub paragraph 3(a) and the commentary as to what constitutes an active business.

As a consequence of the diversity of Institutional Investors' activities this alignment will also need to deal with the current treatment of CIVs and the commentary to sub paragraph 6.

In brief, an Institutional Investor which sets up an ownership vehicle in and manages an asset from State A should be entitled to the benefits of all Treaties with State A. Management of an asset can occur either as direct management by the Institutional Investor by an entity resident in State A or management via an external manager (also resident in State A) who acts on behalf of the Institutional Investor.

It follows from this that a CIV comprised of Institutional Investors should be treated in the same manner as an Institutional Investor.

Article 10(7) (PPT rule) would remain to cover the position of a potential abuse.

2 Introduction

By way of context, we recognise that, at the highest level the Organisation for Economic Co-operation and Development ("OECD") Base Erosion and Profit Shifting ("BEPS") initiative seeks to ensure that the Governments of each Member State receive their fair share of revenue so they can discharge their respective social obligations.

The proposed OECD Model Tax Convention and Commentary in respect of the Limitation on Benefits ("LOB") and Principal Purpose Test ("PPT") rules seek to ensure that taxpayers do not avail themselves of treaty relief in circumstances where it would be inappropriate for them to do so. These provisions also seek to prevent double non-taxation (i.e. where a prima facie taxable entity is exempt from tax both in the country of source and in the country of residence).

2.1 The role of Institutional Investors

In this context, it is important to consider the broader role of Institutional Investors (being SWFs, public pension reserve funds and pension funds) in society as a whole. For further information on SWFs and public pension reserve funds as considered by the OECD[1], please refer to Appendix C.

Institutional Investors are not established to generate wealth or profit for a small group of individuals as in the case of a corporate, rather they are established as a matter of Government policy of each member state to meet intergenerational (ie transfer wealth from the generation which benefits from high commodity prices to spend when the commodity no longer is valuable) or contractual commitments relating to the ongoing retirement obligations for its citizens (e.g. doctors, nurses, police officers, military personnel, etc), or in some countries the entire population.

[1] Adrian Blundell-Wignall, Yu-Wei Hu and Juan Yermo, *Sovereign Wealth and Pension Fund Issues*, 2008

Institutional Investors differ from corporate investors in six material aspects, which are discussed in further detail below:

1. They are generally exempt from tax in their home market, albeit taxable in foreign jurisdictions;
2. They seek to match income flows with contractual or intergenerational commitments;
3. The use of external managers and regional offices to manage their investments;
4. Their predominant "liabilities" (whether they are future pension payments or intergenerational social welfare obligations) are in their home currency;
5. Asset allocation; and
6. Risk profile and fiduciary obligations.

1. Exemption from income tax in home market

Institutional Investors are generally exempt from income tax in their home country on public policy ground due to their stated social purpose, which is to meet intergenerational or contractual commitments relating to pension obligations.

This is recognised in most jurisdictions as distinct from the purpose of corporations, which seek to benefit individuals through their profit making endeavours.

Tax exemption means Institutional Investors are not driven to locate entities in foreign jurisdictions to avoid home country tax. It should also be borne in mind that Institutional Investors have fiduciary obligations in managing their assets and the choice of a regional office or external manager will turn on numerous factors dealing with reciprocity of law especially when common law countries invest in civil law jurisdictions.

As set out later in this submission, many countries have sought to create incentives to attract foreign based Institutional Investors to invest in their host markets as they represent a long term, stable source of capital for investments that pay stable cash flows.

2. They seek to match income flows with contractual or intergenerational commitments

Institutional Investors can be most easily distinguished from corporate investors in that they do not operate to maximise profits for their shareholders, rather they operate with a view to meeting contractual (e.g. defined benefit or defined contribution pension plans) or intergenerational commitments (future income flows to ensure continued prosperity for States with economies tied to finite exhaustible resources – e.g. Saudi Arabia). This significantly impacts the risk profiles and asset mix of each Institutional Investor and is often further controlled through legislation

3. The use of external managers and regional offices to manage the investment

Institutional Investors are generally likely to employ both regional offices and external managers to administer and manage their investments. This is due to a number of reasons, predominantly related to the fact that they invest across a wide portfolio of assets in various global markets. We have set out in section 5 below the asset classes and geographies in which investments are made.

In the case of a very large investment, (eg infrastructure and large real estate investments) these are generally made in consortiums. By way of an example, Institutional Investors will typically invest in infrastructure and large real estate assets as part of a consortium, usually comprising three to five investors, which allows these investors to better manage their risk profile and exposure to any one asset. In these cases, it is often beneficial to appoint an external manager or establish a regional office in a central third country to manage the investments being made, especially where the investors are situated in many different countries. This type of structure allows for governance rights to be exercised in an efficient manner (especially where time zones are an issue) while also allowing investors the flexibility to appoint an expert manager to efficiently manage the asset. Institutional Investors will generally not have the in-house expertise themselves to manage for example a toll-road or an airport.

In our view, the structure of the CIV industry described in the CIV Report[2] focussed exclusively on portfolio equity and debt funds. In these funds the underlying investors have no direct rights over the assets in the fund and rely entirely upon the manager to make all decisions regarding the operation of the fund. This should be contrasted with a consortium of Institutional Investors purchasing an infrastructure asset through a CIV created for the particular acquisition[3]. The Institutional Investors will each individually have governance rights that will give the particular investor proportionate control over the asset. In respect to a number of matters it is common for investors to have “negative control” over important decisions. Negative control is the ability of an Institutional Investor on protective grounds to block a decision made by the majority of the investors.

A comparison of the world’s largest companies[4] with the world’s largest Institutional Investors[5] shows the following statistics:

1. Almost 25% of the world’s largest 100 companies by market capitalisation would be displaced by Institutional Investors if Institutional Investors’ net worth was defined as market capital;
2. The world’s largest companies are geographically represented by subsidiaries throughout the world whereas Institutional Investors have regional offices to manage foreign investments; and
3. The world’s largest companies employ by factors of between 100 and many thousands more employees.

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[2] Section 2.2ff

[3] http://www.sovereignwealthcenter.com/Article/3205798/real-estate-and-infrastructure/Powering-Up-Sovereign-Fund-Investment-in-Infrastructure.html#.VKnlLdgcR3Y

[4] www.corporateinformation.com

[5] www.towerswatson.com; www.sovereignwealthcentre.com

The differences largely turn on the fact that Institutional Investors do not deal directly with individuals in foreign markets and that their direct investments[6] in foreign markets tend to be real estate and infrastructure.

4. Their predominant liabilities are in their home currency

As Institutional Investors are established to meet future contractual or intergenerational obligations, the relevant liabilities they are seeking to manage are also in the home currency. It should be noted the even where a pension fund is managed by an employer or a third party not controlled by Government, pension funds are all regulated by Government. The reason for the regulation is primarily on public policy grounds to ensure that retirees are self-funded. The alternative to adequate self-funding for retirees means that greater costs would be placed on future public spending through additional social welfare payments.

This means that Institutional Investors will seek to invest in assets that generate stable cash flows and are either not subject to significant foreign exchange rate fluctuations or the investment is hedged against this. This also means that Institutional Investors are also likely to retain significant cash reserves or liquid assets in their home currency to ensure they can meet these obligations as they fall due.

This is not consistent with the general investment patterns of multinational corporates, which would have liabilities in a number of currencies and would also seek to maximise returns through leveraging their operations.

5. Asset allocation

In line with the stated purpose of Institutional Investors, which is to meet future contractual or intergenerational obligations, asset allocations for these investor types are generally weighted towards low-risk cash and equity type investments (e.g. Government bonds).

A sample asset allocation for an Institutional Investor may be:

- Portfolio dividends, cash and low-risk debt interests (55-85%); and
- Real estate, infrastructure and private equity type investments (15-45%).

Whilst alternative investments (e.g. real estate, infrastructure, agricultural and private equity) are by percentage terms smaller than portfolio investments in absolute terms, they are still material in a global sense.

These asset investments can be either direct investments (with governance rights and obligations) or fund investments (where there are no governance rights or obligations or those rights and obligations are more limited). The mix of direct and fund investments varies depending on the Institutional Investor and their desired asset mix.

[6] A direct invest is an investment where the Institutional Investor has governance obligations which will be exercised either directly or indirectly

A complicating factor is the fact that the rate of return on asset classes, especially infrastructure is relatively low[7] given its very long term nature. Where rates of return are low consortiums between likeminded Institutional Investors can be distorted when each investor has a different tax outcome.

In recent years, Institutional Investors have been demonstrating an increased appetite for direct infrastructure and real estate investments[8,9], which has been largely explained due to the low-risk and long term cash flow characteristics of these investment types. It is important to note that these investments are largely passive, with Institutional Investors generally being more interested in matching cash flows to obligations as opposed to generating growth and profits through active involvement in businesses.

The principal concerns we have with Action Plan 6 is its potential impact on global infrastructure and real estate investment. The concern arises if;

1. an "equivalent beneficiary" approach is taken;
2. the OECD determines that managing real estate and infrastructure assets is not an active business; and
3. Institutional Investors managing their own assets is not an active business.

6. Risk profile and fiduciary obligation

In line with their stated purpose, Institutional Investors are operating to meet certain obligations for the benefit of their beneficiaries, whether these be future generations, the recipients of pensions or the relevant Government. This purpose means that Institutional Investors are highly conservative and are likely to invest in a wide variety of assets to diversify their portfolio and manage risk through traditional hedging and portfolio management theory. Institutional Investors are also likely to invest as part of consortia to limit exposure to large, illiquid assets while still accessing desirable cash flows from real estate and infrastructure investments. The investment behaviour of Institutional Investors is also influenced by their fiduciary obligations to their beneficiaries. These beneficiaries vary depending on the type of obligation being met by the investor, with pensioners being the fiduciary for defined contribution plans as they have invested directly in the fund, the Government being the fiduciary for defined benefit plans as the fund is meeting a Government obligation and the future generations of beneficiaries being the beneficiaries for sovereign wealth funds that augment Government revenues.

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[7] http://www.ceoforum.com.au/article-detail.cfm?cid=6309&t=/Kirsty-MackayFisher-Berkley-Group/Understanding-infrastructure-investments

[8] http://www.ampcapital.com/site-assets/articles/media-releases/2014/2014-12/amp-capital-s-outlook-for-real-assets-in-2015 - accessed 29 December 2014

[9] http://www.sovereignwealthcenter.com/Article/3364126/real-estate-and-infrastructure/Sealing-Big-Deals-Sovereign-Wealth-Funds-Past-Half-Decade.html#.VKArvl4CA – accessed 29 December 2014

2.2 *The importance of Institutional Investors in global capital flows*

Institutional Investors, in particular pension funds and sovereign wealth funds, are an increasingly important source of global investment capital. Sovereign wealth funds spent a total of $43.5 billion on 184 direct investments in 2013[10] and had a total of US$7.057 trillion of assets under management as at December 2014[11]. Similarly, the top 300 pension funds (including sovereign funds) had an estimated US$15 trillion of assets under management to December 2013[12].

Traditionally, Institutional Investors have been seen as sources of long-term capital with investment portfolios built around the two main asset classes (bonds and equities) and an investment horizon tied to the often long-term nature of their liabilities. In recent years Institutional Investors have diversified portfolios by adding allocations to alternative investments such as private equity, real estate, infrastructure, agricultural and hedge funds in OECD markets. They generally seek to operate in long-term, relatively illiquid investments which pay a steady rate of return.

The OECD itself has studied the unique attributes that Institutional Investors can provide to stimulate the global economy and has been a thought leader in presenting this opportunity to the G20 and APEC.[13]

> *"The fallout from financial crisis has exposed the limitations of relying on traditional sources of long-term investment finance such as banks. Governments are looking for other sources of funds to support the long-term projects that are essential to sustaining a dynamic economy. There is huge potential among Institutional Investors to support development in a range of areas such as infrastructure, new technology and small businesses."*
>
> Angel Gurria, OECD Secretary-General
>
> G20 Leaders' Summit, St. Petersburg, September 2013

Further, at the recent G20 Leaders Summit held in November 2014, in Brisbane, Australia, the issue of long-term financing for sustainable and durable growth was an important theme in charting the economic future of member countries. G20 leaders identified structural reforms and quality investments, particularly in infrastructure, as important conditions to foster job creation and to support long-term growth targets. Promoting institutional investment in infrastructure is increasingly becoming a topic of interest at the G20 as part of this multi-year plan for growth.

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[10] http://www.sovereignwealthcenter.com/qreport/7/Annual-Report-2013.html - accessed 23 December 2014

[11] http://www.swfinstitute.org/fund-rankings/ - accessed 29 December 2014

[12] http://www.towerswatson.com/en-AU/Press/2014/09/Top-pension-fund-assets-hit-15-trillion-US-dollars - accessed 29 December 2014

[13] Years of work undertaken by the OECD was recently summarized in its May 2014 project report "Institutional Investors and Long-Term Investment. http://www.oecd.org/finance/private-pensions/ECD-LTI-project.pdf

It is generally recognised that a common factor for this investor type is the long-term investment timeline and significant capital commitment required for them to meet their future obligations. Accordingly, these investors seek global efficiency from a taxation perspective as they are generally exempt from income taxes in their home market.

Institutional Investors are not seeking an exemption from BEPS or exclusion from the treaty shopping and other such integrity provisions, rather they are seeking to ensure that these provisions operate in a uniform way that will not distort their ultimate economic outcomes on the basis of investment structure into their target jurisdiction.

2.3 Concessionary treatment for Institutional Investors

We note that the unique investment profile and character of Institutional Investors and their increasingly prevalent role in providing stable long-term capital in infrastructure and real estate investments has been recognised by a number of States which have passed legislation providing concessionary tax treatment for pension and sovereign wealth funds and their subsidiaries, usually in the form of an exemption from withholding taxes. These measures reflect the importance afforded by many Governments to attracting long term capital inflows to advance broader national economic policy initiatives, in the context of a highly competitive global capital market.

There are some jurisdictions at present which provide some form of exemption (a form of sovereign immunity) from income taxes to foreign governments and Institutional Investors include Australia, Germany, Canada, USA, UK, France and Korea[14]. It is expected that given the increasingly competitive environment to attract global capital as well as pressing domestic requirements to expand and/or upgrade infrastructure and other assets these countries may seek to offer some tax preferences to Institutional Investors.

Currently many countries offer alternative incentives to sovereign immunity for Institutional Investors. For instance, Australia:

- exempts certain Institutional Investors from some income tax in Australia;
- has a Managed Investment Trust ("MIT") regime (which provides a concessional 15% withholding rate for distributions made by widely held funds – Institutional Investors being regarded as widely held - investing either directly or indirectly in assets generating passive income – discussed at Appendix D);
- exempts certain foreign pension funds from interest and dividend withholding tax; and
- provides certain domestic pension funds with an effective exemption from income tax through the use of refundable franking credits through the dividend imputation system.

Another example of concessionary legislation is the United States' ("US") *Foreign Account Tax Compliance Act* ("FATCA") regulations (also discussed at Appendix D), which have identified

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[14] For a more detailed listing see www.law.wisc.edu/m/y2njd/swfs_taxation_arial_717_08.doc - accessed 29 December 2014

foreign governments and foreign superannuation funds and retirement plans (as well as certain wholly owned entities) as low risk entities for US tax evasion purposes and have thus excluded them from the requirements to trace their ownership to identify US members or potential US members.

Additionally, in the US there has been recent discussion on exempting foreign pension funds from paying capital gains taxes on the disposal of real property and infrastructure interests in the US. The US treasury excerpt below highlights the unique role pension funds play in long-term infrastructure investments both in the US and globally, and highlights the US's recognition of the impact that tax imposts have on distorting choice of investment destination:

> *"Infrastructure assets can be attractive investments for long-term investors such as pension funds that value the long-term, predictable, and stable nature of the cash flows associated with infrastructure. With U.S. pension funds generally exempt from U.S. tax upon the disposition of U.S. real property investments, the Administration proposes to put foreign pension funds on an approximately equal footing: exempting their gains from the disposition of U.S. real property interests, including infrastructure and real estate assets, from U.S. tax under FIRPTA."*[15]

The various unilateral tax concessions granted by Governments worldwide to Institutional Investors to advance broader domestic economic policy initiatives recognise their unique status and operations and further distinguish them from those of multinational corporates.

2.4 Public Policy Considerations

The OECD recognises the role of non-profit organisations in the current draft of Article 10. As has been set out pension funds are globally active in seeking to provide retirement income for contributors. As set out in the numerous footnotes the largest pension funds are those devoted to government employees. Any additional costs imposed upon pension funds (including administration) are in the long term additional social welfare costs imposed upon governments. It should be noted that China, Malaysia and Singapore have amongst the world's largest pension funds and sovereign wealth funds.

Both pension funds and sovereign wealth funds serve the same social function of providing future earnings for the citizens of a particular country.

2.5 Impact of proposed LOB and PPT articles on Collective Investment Vehicles ("CIV's")

The Public Discussion Draft refers to the proposed wording of the LOB and PPT articles in the Action Plan 6, and recognises that a number of funds use interposed entities to manage and / or structure their investments.

We are confident that no Government globally is seeking to disadvantage or dissuade Institutional Investors from investing in their markets. Accordingly, it is submitted that specific

[15] http://www.treasury.gov/press-center/press-releases/Pages/jl1887.aspx - accessed 22 December 2014

consideration should be afforded to the practices of Institutional Investors as part of the BEPS project. It should also be acknowledged that the Institutional Investors themselves are predominantly government owned or regulated and they operate in a different manner to multinational corporates.

As previously noted, unlike multinational corporates which often operate with branches in multiple countries, Institutional Investors are likely to use specialist external managers or regional offices to manage their investments and exercise their governance rights and obligations. This is often necessitated as a matter of practicality when pooling capital for investment in a large infrastructure asset as part of a consortium, or where time zones or geographical distances make the exercise of these rights and obligations impractical from the home country.

Often the external managers and regional offices are resident in a jurisdiction other than where the Institutional Investor is resident. This is the principal situation where adverse and inequitable taxation outcomes could arise if the present BEPS Action Item 6 rules are not modified.

Work is required to ensure that whatever the final form of Action Plan 6, that it:

- does not dissuade global capital flows arising from Institutional Investors;
- does not change the ability of host jurisdictions to attract global capital; and
- allows Institutional Investors to diversify asset allocation into foreign markets to manage their risk.

The proposed amendments to the LOB and PPT provisions, as currently drafted, may lead to a number of unintended adverse outcomes from a taxation perspective for Institutional Investors which are presently investing through a CIV or manager in a third State (i.e. a State that is neither the investment destination, nor the country of residence for the investor).

The use of a CIV or manager in a third state is one of the most common structuring options used by Institutional Investors for their investments and may have a number of advantages over direct investment:

- Economies of scale through pooling of capital - investment exposure to larger assets;
- Geographical proximity to the underlying asset's jurisdiction, which may assist in exercising governance rights over the asset;
- Better investment risk management through portfolio diversification; and
- Access to specialist manager expertise.

In most cases, investment through an intermediary is a case of economic and practical necessity such that the investment can be managed in an effective way and governance rights and obligations can be exercised and fulfilled.

Institutional Investors are generally experienced in selecting and administering their investment portfolio, but are unlikely to be directly involved in the day-to-day operation of the assets they acquire as, in the case of smaller funds, they may lack the necessary expertise to extract the maximum return. Similarly, as funds generally invest in a number of assets (and are an increasingly important source of global investment capital), it is inefficient to maintain large numbers of personnel to manage investments all over the world. In the case of some Institutional Investors, their constituent documents may even prohibit direct investment in non-financial assets. Accordingly, for assets like infrastructure and real estate, minority stakes in CIVs may be the only permissible way to.

To overcome this capability gap, it is common practice for Institutional Investors to appoint a sophisticated manager, who has experience in operating the assets which they have acquired. This has resulted in the rise in popularity of CIV's situated in the jurisdiction where the fund manager is based as opposed to investment vehicles situated in the State in which the asset is located.

3 Case Studies

Three case studies are provided below which illustrate common investment scenarios for Institutional Investors.

Our case studies have not included investments in portfolio equity and debt. Generally these investments are the largest allocation of all Institutional Investors' capital investment. These investments are generally held directly from the home market as there is no requirement for any level of governance over portfolio investments.

Case Studies 1 and 2 require a significant level of governance and oversight. Accordingly for the reasons set out below it is not feasible to manage the investments from the home market. It is in these circumstances that it is critical to understand the differences between a corporate investor and Institutional Investors.

If you compare the world's largest companies[16] with the largest pension funds[17] and the largest sovereign wealth funds [18] a significant number of Institutional Investors would be included within the Top 100 companies by market capitalisation (9 sovereign wealth funds and 26 pension funds). However if we compared total number of employees no sovereign wealth fund or pension fund would be close to the range and number of employees of a major corporate investor.

The major factors leading to this are as follows:

1. Institutional Investors generally own assets such as infrastructure and real estate in consortiums where each investor has governance rights. Those governance rights can be exercised by a manager;

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[16] www.corporateinformation.com

[17] www.towerswatson.com

[18] www.sovereignwealthcentre.com

2. Generally individual assets are held in discrete locations rather global operating businesses (see below the Frankfurt Airport example);
3. Where assets are pooled they are generally managed by an external manager and governance rights of the Institutional Investor are exercised by a regional office or another external manager (see French real estate example below);
4. Where assets are pooled by an external manager and there are no governance rights in the hands of Institutional Investors (ie the investors to the PE Fund), the investment into the PE Fund by the Australian or NZ Institutional Investor is made generally directly from Australia or New Zealand (see private equity example below).

Case Study 1

There are four global Institutional Investors which comprise a consortium that is seeking to invest in the Frankfurt Airport. These investors are headquartered in Australia, Canada, the UK and Dubai.

To pool their capital, these entities set up an investment vehicle in a jurisdiction with clear rules on CIV's and which provides recognition of both Civil and Common law jurisdictions (e.g. Luxembourg or Ireland).

The Consortium either appoints an external manager based in the location of the fund or directly employs experts in either Luxembourg or Ireland to manage the investment.

Case Study 2

An unlisted wholesale Real Estate Fund is set up to invest in real estate in France by an International Bank. A New Zealand Institutional Investor will hold 15% of the fund and will have certain governance rights regarding the fund. Rather than holding the asset directly from New Zealand it will hold the asset either through a regional office of the Institutional Investor resident in Europe or gives powers of management to an external manager who will act as nominee for the Institutional Investor in the country in which the manager is based. The use of either the regional office or the external manager is to allow the Institutional Investor to manage its governance rights in an efficient manner taking into account geography and time zones. Depending on the type of Institutional Investor or the purpose of the investment the asset may be held in a single asset holding structure or as part of a wider holding vehicle.

Due to the geographical and time zones differences between New Zealand and France, it is difficult for the Institutional Investor to exercise governance rights directly from New Zealand.

Case Study 3

A global private equity manager sets up a fund in Ireland or Luxembourg. Contracts relating to the fund impose restrictions such that the only way an Australian or NZ Institutional Investor can invest is through the intermediate fund entity and has no way of investing in the underlying assets directly. Typically this type of fund is unlisted and attracts investors from all over the world.

3.1 Comments in relation to the case studies

Case Study 1 is a common fact pattern. A group of Institutional Investors will bid for a large infrastructure asset either as a Greenfield (ie construction of a new asset) or Brownfield (ie a secondary market transaction) project. The joint venture vehicle is required to be in a jurisdiction in which each of the following characteristics can be satisfied:

1. It is resident in jurisdiction that allows both civil and common law investors to participate without prejudice.
2. It is resident where the majority of Institutional Investors have employees or external managers who will be responsible for exercising the governance rights attached to the ownership interests and
3. Most importantly it is located in a jurisdiction which has clear and regulated collective investment rules.

Consistent with the Approach in Article 10(3)(a) if the German asset is held say in an Irish fund vehicle and is managed and controlled in Ireland by an Irish fund manager for each of the investors or alternatively the asset was managed by regional offices for each of the Institutional Investors based in Ireland it is our view that the appropriate treaty to consider is the Irish/German treaty. This is because Ireland is where the active business decisions of managing the asset are made from.

In respect of Case Study 2, an International Bank has set up a Real Estate Fund in France and will seek say 5-6 investors. Due to the nature of the Real Estate Fund each investor will have governance rights over a number of issues.

The New Zealand investor has decided that due to the geographical and time zone differences it is difficult to manage the investment from New Zealand and has decided to allow an external manager to control its governance rights. The investment is undertaken through an entity in a third State, which is generally where the external manager is resident. Alternatively if a Regional Office of the Institutional Investor had the expertise and was in the appropriate time zone the investment entity would be created in the jurisdiction where the regional office is resident.

The Institutional Investor is using either the external manager or its Regional Office to provide greater proximity between the asset and the co-investors and thus serves to maximise returns for investors while assisting the investors in managing their governance obligations through reducing the 'lag' time for operational decisions to be made.

Accordingly it is our view that the business of the New Zealand investor is actively carried on where the manager or the Regional office is based.

Case Study 3 is an example of a where funds invest with an established manager and is an example of a private equity type investment model. The Institutional Investor in this case has limited governance rights and is likely entirely passive.

At a technical level, for Case Studies 1 and 2, the physical asset is situated in one country, the investor is in a second country, and the investment is made through a third country. Because of their geographical spread of investments and the fact that Institutional Investors have governance rights the use of a third country is to allow geographically distant assets to effectively and efficiently be managed by allowing each investor to exercise its governance rights and satisfy its governance obligations on a timely and efficient basis.

If the differences between the business of a corporate and an Institutional Investor were taken into account we consider that the governance rights constitute an active trade or business as set out in Article 10(3)(a).

Case Study 3 is structured in a similar way, but necessitates investment through an intermediate entity and requires that the investors ultimately surrender full control of administration of investment to the manager which has established the fund.

We would submit that the PE Fund is resident in the country in which the manager is based. Due to the absence of governance rights the investment by the Institutional Investor to the PE Fund would be made direct from the home country. Therefore if the PE Fund Manager manages the Fund from Ireland it would be our view that the Manager should be treated as having an active business of fund management based in Ireland. Therefore the CIV should be entitled to the Irish treaty network.

Whilst the CIV Report at paragraphs 52-59 expresses concern about treaty shopping we consider that the modified sub paragraph (3)(a) of proposed Article 10 can adequately deal with concerns on treaty shopping. The CIV Report continually refers to concerns about investors participating into a CIV for the purpose of obtaining a particular treaty outcome better than they could have if they invested directly. If we examine a PE Fund, the Manager has an active role in managing and dealing with assets. The active role of a Manager can be seen in the fact that Institutional Investors select private equity firms on the basis of the personnel within a region and indeed frequently negotiate protective rights to either terminate the fund or have the fund cease making new investments in the event of “key person” exits from the Manager. Accordingly if an Institutional Investor was prepared to be as active a Manager as a Fund Manager that Investor would also get the benefits of Article 10 (3)(a).

It is important to acknowledge that due to the scale and size of Institutional Investors, there are a number of Australian funds with personnel in the UK, Ireland and Luxembourg as these are destinations that have been popular for pooling capital prior to investment. These intermediary destinations are also host to a number of managers which are engaged to manage the investments made by funds and other Institutional Investors and which provide significant expertise in the management of specific types of assets (e.g. real estate, infrastructure, etc). The use of managers is considered to be a key driver of efficiency for funds as, due to the significant number of investments undertaken and the number of assets under management, it is not practical for a fund to open an office in each investment destination. Greater commercial efficiency can also be obtained through centralisation and contracting to professional asset managers who have experience running the assets in which the fund is investing.

Accordingly, as many Institutional Investors have existing operations in the UK, Ireland and Luxembourg, it is likely the investment entry point will occur through such a jurisdiction, or alternatively through a jurisdiction where there is sufficient and available expertise that can be engaged to manage the asset (i.e. an asset manager).

4 Tax treaties

As Institutional Investors have mandates to invest prudently such that they can meet future obligations, their investment decisions take into account any tax burden. As these classes of investors are likely exempt from tax in their home jurisdiction, they are highly sensitive to the taxation of investment returns on international investments and rely on tax treaties to help limit the impact on investment yields.

Unfortunately, many tax treaties were written before the advent of Institutional Investors and do not provide efficient outcomes where Institutional Investors invest through CIV's. This can result in anomalous and oftentimes inappropriate taxation outcomes for investors, which mean that investors in the same CIV can face very different tax outcomes.

4.1 LOB provision

As presently drafted, the LOB provision in proposed Article X[19] would not extend treaty protection to any of the funds involved in the three common investment scenarios contemplated in the case studies above. This is due to the current definition of "qualified person" in Paragraph 2, and in particular subparagraph 2(d) of the proposed Article not extending to funds investing through intermediate entities. Further as mentioned in the Discussion Draft the concept of what constitutes an active business will vary between Institutional Investors and Corporate Investors.

This results in an anomalous outcome whereby Institutional Investors investing directly into another member State can access treaty benefits, but those which choose to use an intermediate entity, whether for the purpose of pooling funds or to facilitate the use of an experienced investment manager that is engaged directly to manage the assets being acquired, cannot.

[19] Published in Para 10 of the OECD BEPS Action 2014 Deliverable: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Accordingly, the introduction of a rule such as the proposed LOB article, as currently drafted, would represent an artificial cost of doing business, penalising funds for not investing directly or through listed widely held entities (where they can obtain treaty relief) and resulting in a situation where a pension fund or a sovereign wealth fund obtains two different tax outcomes depending on whether it invests through a listed widely held entity or undertakes a strategy involving an unlisted intermediate vehicle. This would arguably result in disadvantage to the national economies of states that do not provide flow through treatment for intermediate holding vehicles as it would result in funds shifting capital to more favourable investment destinations.

Additionally, we note that where Institutional Investors from different jurisdictions invest through a single pooling entity, the logical outcome should be that they are taxed in a uniform manner. The presently draft of the Article could potentially result in outcomes whereby two Institutional Investors investing in the same asset, through the same CIV could be taxed differently.

It is submitted that the most efficient way in which the objectives of OECD BEPS can be achieved without distorting the taxation outcomes for Institutional Investors is to extend treaty benefits to the investment vehicle or manager in the intermediate jurisdiction provided the Institutional Investor has either a regional office or uses an external manager resident in the intermediate jurisdiction. That is, the relevant treaty would be the one between the intermediate jurisdiction and the investment destination and not the investment destination and the jurisdiction in which the Institutional Investor is resident. In our view this is consistent with Article 10(3)(a).

We note that a 'derivative benefits' test has been proposed, in Article 10(4) as a means of providing relief to entities investing through CIV's. It is submitted that the use of a derivative benefits type test would be very complicated, especially in a scenario where four or five investors in a pooled vehicle would then invest in an asset.

This scenario would require tracing through each individual investor in the pooled vehicle to ascertain whether treaty relief could be obtained for each individual investor having regard to the character of each party's investment. This would be both cumbersome and onerous from a compliance perspective and could result in anomalies where there are variances in the drafting and interpretation of the derivative benefits articles being relied on under each respective treaty.

In a case where the application of the derivative benefits test is not uniform, this may serve to discourage investment through CIV's as it would make pooling capital more difficult and introduce uncertainty as to tax outcome for individual investors.

Provided that all entities investing in the CIV are Institutional Investors, they should generally be exempt from tax in their home jurisdiction. Accordingly, it is submitted that there is no real mischief to be averted that would make the derivative benefits provision appropriate as any asymmetrical outcome between individual investors in a CIV would be anomalous.

5 Conclusion

As set out in this submission Institutional Investors play an important role in the social welfare fabric of their home country. Institutional Investors are also the major investor class to refinance and construct much of the world's infrastructure[20]. The CIV Report focusses mainly on portfolio equity and debt investment by regulated CIVs. A significant proportion of infrastructure and real estate investments made by Institutional Investors is in unregulated funds where the investors have material governance rights.

Without significant changes to Action Plan 6 there will be market distortions in the area of infrastructure and real estate investment. This distortion will arise if an "equivalent beneficiary" approach is adopted by the OECD. As has been set out earlier both real estate and infrastructure have relatively low yields when compared to corporate rates of return. This is the very reason why corporates do not hold infrastructure and do not want real estate on their balance sheets.

When forming consortiums it is critical for investors to value the assets on the same basis. If the test was based on where the asset is managed from then all investors would be treated equally. If the test is a tracing test then some investors will be excluded from some markets due to their home country treaty. This outcome is to no nation's advantage.

Please refer to Appendix A for suggested amendments to the OECD Model Tax Convention and Commentary.

* * * * *

Thank you for the opportunity to provide comments on the Discussion Draft. If you have any questions in relation to our comments, please feel free to contact us.

Yours sincerely	Yours sincerely
Steven Economides Partner	Minh Dao Director

[20] http://www.sovereignwealthcenter.com/Article/3205798/real-estate-and-infrastructure/Powering-Up-Sovereign-Fund-Investment-in-Infrastructure.html#.VKnu2dgcTeJ

6 Appendix A - Entitlement to benefits

Legend to Amendments

1 Article 10 as drafted by the OECD is set out in Dark Blue
2 The commentary as drafted by the OECD is set out in Black
3 Proposed changes and comments are set out in Red
4 Where words have been struck out of the Article or Commentary double strike out is used.
5 Where no change is made the words "No change proposed." are made
6 Where a provision is irrelevant to Institutional Investors the comment "***Not quoted as not relevant"*** is made.
7 Where we have added a new paragraph to the commentary we have used in a letter in the paragraph number as to not disturb the existing numbering system.

Article X together with the Commentary

Paragraph 1

1. Except as otherwise provided in this Article, a resident of a Contracting State shall not be entitled to a benefit that would otherwise be accorded by this Convention (other than a benefit under paragraph 3 of Article 4, paragraph 2 of Article 9 or Article 25), unless such resident is a "qualified person", as defined in paragraph 2, at the time that the benefit would be accorded.

4. No change proposed.

5. No change proposed.

6. No change proposed.

Paragraph 2

2. A resident of a Contracting State shall be a qualified person at a time when a benefit would otherwise be accorded by the Convention if, at that time, the resident is:

7. No change proposed.

8. No change proposed.

Individuals – subparagraph 2 a)

a) an individual;

9. ***Not quoted as not relevant***

Governments – subparagraph 2 b)

b) a Contracting State, or a political subdivision or local authority thereof, or a person that is wholly-owned by such State, political subdivision or local authority. Wholly owned shall be deemed to include bodies created under statute without share capital or membership interests provided all of the income and capital inures only to the benefit of the Contracting State or political subdivision thereof;

10. No change proposed.

Publicly-traded companies and entities – subparagraph 2 c)

11-20. ***Not quoted as not relevant***

Charitable organisations and pension funds – subparagraph 2 d)

d) a person, other than an individual, that

i) is a [list of the relevant non-profit organisations found in each Contracting State],

ii) was constituted and is operated exclusively to administer or provide pension or other similar benefits, or is an investment entity owned by an entity or entities defined in subparagraph 2(b)~~provided that more than 50 per cent of the beneficial interests in that person are owned by individuals resident in either Contracting State,~~ or

iii) was constituted and is operated to invest funds for the benefit of persons referred to in subdivision ii), provided that substantially all the income of that person is derived from investments made for the benefit of these persons

Note

Note

By eliminating the 50% requirement for pension benefits to be provided to residents of a particular jurisdiction very minor drafting changes are required. We have also added to SWFs to subparagraph (ii). If this change is accepted the majority of the other drafting changes will not be required.

21. No change proposed.

22. No change proposed.

Note

On the basis that charities automatically qualify for treaty benefits it is equally relevant to qualify pension funds and SWFs. The majority of pension funds are created for the benefit of employees and public servants[21] whilst SWFs are committed to maintain living standards for their civil population, and each is typically tax exempt in its home country on public policy grounds. Therefore why is there a distinction made?

[21] www.sovereignwealthcentre.com

23. Under subdivision ii), a resident pension fund will qualify for treaty benefits ~~if more than 50 per cent of the beneficial interests in that person are owned by individuals resident of either Contracting State~~. For purposes of this provision, the term "beneficial interests in that person" should be understood to refer to the interests held by persons entitled to receive pension benefits from the fund. ~~Some States, however, may wish to relax the 50 per cent beneficial interest requirement in subdivision ii) (e.g. where a State is part of a regional grouping of States, such as the European Union, which permits pension funds to be constituted in any State which is a member of that regional grouping).~~

23A An investment entity must be distinguished from a trading entity. A trading entity will carry on an active business and other than its shareholding cannot be distinguished from a privately owned entity. Examples of trading entity are government owned electricity companies, telecommunication companies and broadcasters. An investment entity invests across separate asset classes and is used for the purposes of meeting Government liabilities (eg pension liabilities) or is used for the purposes of intergenerational funds transfer.

24. No change proposed.

Ownership / Base Erosion − subparagraph 2 e)

e) a person other than an individual or an entity covered by 2(d), if

i) on at least half the days of the taxable period, persons who are residents of that Contracting State and that are entitled to the benefits of this Convention under subparagraph a), b) or d), or subdivision i) of subparagraph c), of this paragraph own, directly or indirectly, shares representing at least 50 per cent of the aggregate voting power and value (and at least 50 per cent of any disproportionate class of shares) of the person, [provided that, in the case of indirect ownership, each intermediate owner is a resident of that Contracting State], and

ii) less than 50 per cent of the person's gross income for the taxable period, as determined in the person's Contracting State of residence, is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph a), b) or d), or subdivision i) of subparagraph c), of this paragraph in the form of payments that are deductible for purposes of the taxes covered by this Convention in the person's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property);

Note

Neither a charity, pension fund nor Government investor will qualify under this test given their unique investment criteria and size therefore we have amended the sub paragraph.

25. No change proposed.

26. No change proposed.

27. No change proposed.

28. No change proposed.

29. No change proposed.

30. No change proposed.

Collective investment vehicles − subparagraph 2 f)

f) [possible provision on collective investment vehicles]1 [Footnote 1] This subparagraph should be drafted (or omitted) based on how collective investment vehicles are treated in the Convention and are used and treated in each Contracting State: see the Commentary on the subparagraph and paragraphs 6.4 to 6.38 of the Commentary on Article 1.

Note

Provided the definition of active business is amended to include a fund business the issue is largely academic. Nevertheless we should point out that the significant majority of CIVs are not publically listed. The test should be where the fund is actually administered and managed.

31. As indicated in the footnote to subparagraph f), whether a specific rule concerning collective investment vehicles (CIVs) should be included in paragraph 2, and, if so, how that rule should be drafted, will depend on how the Convention applies to CIVs and on the treatment and use of CIVs in each Contracting State. Such a specific rule will frequently be needed since a CIV may not be a qualified person under either the other provisions of paragraph 2 or 3, because, in many cases

− the interests in the CIV are not publicly-traded (even though these interests are widely distributed);
− these interests are held by residents of third States; **and**
− the distributions made by the CIV are deductible payments, ~~and~~
~~− the CIV is used for investment purposes rather than for the "active conduct of a business" within the meaning of paragraph 3.~~

Note

The CIV Report covers only portfolio asset funds. An infrastructure or real estate fund is actively managed as reinvestment decisions need to be made on a regular basis. The entire commentary flows from an analysis of the CIV Report. As we have submitted the report ignores the operations of infrastructure and real estate unregulated wholesale funds. The underlying management of the assets which are set out in our submission should constitute an active business. Accordingly we are not comfortable with any of the drafting as it proceeds on an assumption that investors have no governance obligations. Whilst this may be the case for the very large funds on the wholesale funds each investor generally has governance obligations. Whilst we have not struck out paragraphs 32-43 we do not think those paragraphs apply to all CIVs.

32. Paragraphs 6.8 to 6.34 of the Commentary on Article 1 discuss various factors that should be considered for the purpose of determining the treaty entitlement of CIVs and these paragraphs are therefore relevant when determining whether a provision on CIVs should be included in paragraph 2 and how it should be drafted. These paragraphs include alternative provisions that may be used to deal adequately with the CIVs that are found in each Contracting State. As explained below, the use of these provisions may make it unnecessary to include a specific rule on CIVs in paragraph 2, although it will be important to make sure that, in such a case, the definition of "equivalent beneficiary", if the term is used for the purposes of one of these alternative provisions, is adapted to reflect the definition included in paragraph 6.

Note

Please refer to the Note to paragraph 31

33. If it is included, subparagraph f) will address cases where a Contracting State agrees that CIVs established in the other Contracting State constitute residents of that other State under the analysis in paragraphs 6.9 to 6.12 of the Commentary on Article 1 (such agreement may be evidenced by a mutual agreement as envisaged in paragraph 6.16 of the Commentary on Article 1 or may result from judicial or administrative pronouncements). The provisions of the Article, including subparagraph f), are not relevant with respect to a CIV that does not qualify as a resident of a Contracting State under the analysis in paragraphs 6.9 to 6.12 of the Commentary on Article 1. Also, the provisions of subparagraph f) are not relevant where the treaty entitlement of a CIV is dealt with under a treaty provision similar to one of the alternative provisions in paragraphs 6.17, 6.21, 6.26, 6.27 and 6.32 of the Commentary on Article 1.

Note

Please refer to the Note to paragraph 31

34. As explained in paragraphs 6.19 and 6.20 of the Commentary on Article 1, Contracting States wishing to address the issue of CIVs' entitlement to treaty benefits may want to consider the economic characteristics, including the potential for treaty shopping, of the different types of CIVs that are used in each Contracting State.

Note

Please refer to the Note to paragraph 31

35. As a result of that analysis, they may conclude that the tax treatment of CIVs established in the two States does not give rise to treaty-shopping concerns and decide to include in their bilateral treaty the alternative provision in paragraph 6.17 of the Commentary on Article 1, which would expressly provide for the treaty entitlement of CIVs established in each State and, at the same time, would ensure that they constitute qualified persons under subparagraph a) of paragraph 2 of the Article (because a CIV to which that alternative provision would apply would be treated as an individual). In such a case, subparagraph f) should be omitted. States that share the view that CIVs established in the two States do not give rise to treaty shopping concerns but that do not include in their treaty the alternative provision in paragraph 6.17 of the Commentary on Article 1 should ensure that any CIV that is a resident of a Contracting State should constitute a qualified person. In that case, subparagraph

f) should be drafted as follows: f) a CIV [a definition of CIV would be included in subparagraph f) of paragraph 6];

Note

Please refer to the Note to paragraph 31

36. The Contracting States could, however, conclude that CIVs present the opportunity for residents of third States to receive treaty benefits that would not have been available if these residents had invested directly and, for that reason, might prefer to draft subparagraph f) in a way that will ensure that a CIV that is a resident of a Contracting State will constitute a qualified person but only to the extent that the beneficial interests in the CIV are owned by equivalent beneficiaries. In that case, subparagraph f) should

be drafted as follows: f) a collective investment vehicle, but only to the extent that, at that time, the beneficial interests in the CIV are owned by residents of the Contracting State in which the collective investment vehicle is established or by equivalent beneficiaries.

> **Note**
>
> Please refer to the Note to paragraph 31

37. That treatment corresponds to the treatment that would result from the inclusion in a tax treaty of a provision similar to the alternative provision in paragraph 6.21 of the Commentary on Article 1. As explained in paragraphs 6.18 to 6.24 of the Commentary on Article 1, the inclusion of such an alternative provision would provide a more comprehensive solution to treaty issues arising in connection with CIVs because it would address treaty-shopping concerns whilst, at the same time, clarifying the tax treaty treatment of CIVs in both Contracting States. If that alternative provision is included in a tax treaty, subparagraph f) would not be necessary as regards the CIVs to which that alternative provision would apply: since that alternative provision provides that a CIV to which it applies shall be treated as an individual (to the extent that the beneficial interests in that CIV are owned by equivalent beneficiaries), that CIV will constitute a qualified person under subparagraph a) of paragraph 2 of the Article.

> **Note**
>
> Please refer to the Note to paragraph 31

38. The approach described in the preceding two paragraphs, like the approach in paragraphs 6.21, 6.26 and 6.28 of the Commentary on Article 1, makes it necessary for the CIV to make a determination, when a benefit is claimed as regards a specific item of income, regarding the proportion of holders of interests who would have been entitled to benefits had they invested directly. As indicated in paragraph 6.29 of the Commentary on Article 1, however, the ownership of interests in CIVs changes regularly, and such interests frequently are held through intermediaries. For that reason, the CIV and its managers often do not themselves know the names and treaty status of the beneficial owners of interests. It would therefore be impractical for the CIV to collect such information from the relevant intermediaries each time the CIV receives income. Accordingly, Contracting States should be willing to accept practical and reliable approaches that do not require such daily tracing. As indicated in paragraph 6.31 of the Commentary on Article 1, the proportion of investors in the CIV is likely to change relatively slowly even though the identity of individual investors will change daily. For that reason, the determination of the extent to which the beneficial interests in a CIV are owned by equivalent beneficiaries should be made at regular intervals, the determination made at a given time being applicable to payments received until the following determination. This corresponds to the approach described in paragraph 6.31 of the Commentary on Article 1, according to which:

> … it would be a reasonable approach to require the CIV to collect from other intermediaries, on specified dates, information enabling the CIV to determine the proportion of investors that are treaty-entitled. This information could be required at the end of a calendar or fiscal year or, if market conditions suggest that turnover in ownership is high, it could be required more frequently, although no more often than the end of each calendar quarter. The CIV could then make a claim on the basis of an average of those amounts over an agreed-upon time period. In adopting such procedures, care would have to be taken in choosing the measurement dates to ensure that the CIV would have enough time to update the information that it provides to other payers so that the correct amount is withheld at the beginning of each relevant period.

Note

Please refer to the Note to paragraph 31

39. Another view that Contracting States may adopt regarding CIVs is that expressed in paragraph 6.26 of the Commentary on Article 1. Contracting States that adopt that view may wish to draft subparagraph f) so that a CIV that is a resident of a Contracting State would only constitute a qualified person to the extent that the beneficial interests in that CIV are owned by residents of the Contracting State in which the CIV is established. In that case, subparagraph f) should be drafted as follows:

> f) a collective investment vehicle, but only to the extent that, at that time, the beneficial interests in the collective investment vehicle are owned by residents of the Contracting State in which the collective investment vehicle is established. Since the inclusion of the alternative provision in paragraph 6.26 of the Commentary on Article 1 would achieve the same result with respect to the CIVs to which it would apply, subparagraph f) would not be necessary, if that alternative provision is included in a treaty, as regards the CIVs to which that provision would apply.

Note

Please refer to the Note to paragraph 31

40. A variation on the preceding approach would be to consider that a CIV that is a resident of a Contracting State should constitute a qualified person if the majority of the beneficial interests in that CIV are owned by individuals who are residents of the Contracting State in which the CIV is established. This result could be achieved by omitting subparagraph f) and simply relying on the application of subparagraph 2) e) (the so-called ownership and base erosion test).

Note

Please refer to the Note to paragraph 31

41. Another possible view that the Contracting States could adopt would be to conclude that the fact that a substantial proportion of the CIV's investors are treaty-eligible is adequate protection against treaty shopping, and thus that it is appropriate to provide an ownership threshold above which benefits would be provided with respect to all income received by a CIV. An alternative provision that would ensure that result is included in paragraph 6.27 of the Commentary on Article 1 and subparagraph f) would not be necessary, if the Contracting States include that provision in their bilateral treaty, with respect to the CIVs to which the provision would apply. If that provision is not included in the treaty, the scope of subparagraph f) could be broadened in order to achieve a similar result by referring to "a collective investment vehicle, but only if [ ] per cent of the beneficial interests in the collective investment vehicle are owned by residents of the Contracting State in which the collective investment vehicle is established and equivalent beneficiaries".

Note

Please refer to the Note to paragraph 31

42. Similarly, the Contracting States may use the alternative provision in paragraph 6.32 of the Commentary on Article 1 where they consider "that a publicly-traded collective investment vehicle cannot be used effectively for treaty shopping because the shareholders or unit holders of such a collective investment vehicle cannot individually exercise control over it". In such case, subparagraph f)

would not be necessary with respect to the CIVs to which the alternative provision would apply. States that share that view but that have not included the alternative provision in their treaty could draft subparagraph f) to read: f) a collective investment vehicle if the principal class of shares in the collective investment vehicle is listed and regularly traded on a recognised stock exchange.

Note

Please refer to the Note to paragraph 31

43. Finally, as explained in paragraph 6.25 of the Commentary on Article 1, States that share the concern described in that paragraph about the potential deferral of taxation that could arise with respect to a CIV that is subject to no or low taxation and that may accumulate its income rather than distributing it on a current basis may wish to negotiate provisions that extend benefits only to those CIVs that are required to distribute earnings currently. Depending on their drafting, such provisions may render subparagraph f) unnecessary.

Note

Please refer to the Note to paragraph 31

Paragraph 3 – Active conduct of a business 3.

a) A resident of a Contracting State will be entitled to benefits of this Convention with respect to an item of income derived from the other Contracting State, regardless of whether the resident is a qualified person, if the resident is engaged in the active conduct of a business in the first-mentioned Contracting State (other than the business of making or managing investments for the resident's own account, unless these activities are banking, insurance or securities activities carried on by a bank <u>or [list financial institutions similar to banks that the Contracting States agree to treat as such] or these activities are investment activities carried on by an entity covered by clause 2(d) or a collection of investors comprising exclusively entities covered by clause 2(b)</u> or, insurance enterprise or registered securities dealer respectively), and the income derived from the other Contracting State is derived in connection with, or is incidental to, that business.

b) If a resident of a Contracting State derives an item of income from a business activity conducted by that resident in the other Contracting State, or derives an item of income arising in the other Contracting State from an associated enterprise, the conditions described in subparagraph a) shall be considered to be satisfied with respect to such item only if the business activity carried on by the resident in the first-mentioned Contracting State is substantial in relation to the business activity carried on by the resident or associated enterprise in the other Contracting State. Whether a business activity is substantial for the purposes of this paragraph will be determined based on all the facts and circumstances.

c) For purposes of applying this paragraph, activities conducted by persons connected to a person shall be deemed to be conducted by such person. A person shall be connected to another if one possesses at least 50 per cent of the beneficial interest in the other (or, in the case of a company, at least 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or another person possesses at least 50 per cent of the beneficial interest (or, in the case of a company, at least 50 per cent of the aggregate voting power and value of the company's shares or of the beneficial equity interest in the company) in each person. In any case, a person shall be considered to be

connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

44. No change proposed.

45. A resident of a Contracting State may qualify for benefits under paragraph 3 whether or not it also qualifies under paragraph 2. Under the active-conduct test of paragraph 3, a person ~~(typically a company)~~ will be eligible for treaty benefits if it satisfies two conditions: (1) it is engaged in the active conduct of a business in its State of residence; and (2) the payment for which benefits are sought is related to the business. In certain cases, an additional requirement that the business be substantial in size relative to the activity in the source State generating the income must be met.

Note

As set out in our submission a consortium of Institutional Investors managing real estate assets or infrastructure assets have governance obligations along the lines of a partner rather than a shareholder. The comment dealing with companies is unduly prejudicial. As already set out many Institutional Investors' assets under management exceed the market capitalisation of any of the world's banks.

46. No change proposed.

47. The term "business" is not defined and, under the general rule of paragraph 2 of Article 3, must therefore be given the meaning that it has under domestic law. An entity generally will be considered to be engaged in the active conduct of a business only if persons through whom the entity is acting (such as officers or employees of a company **or an investment manager in the case of a pension fund or SWF**) conduct substantial managerial and operational activities.

48. The business of making or managing investments for the resident's own account will be considered to be a business only when the relevant activities are part of banking, insurance or securities activities conducted by a bank or financial institution that the Contracting States would consider to be similar to a bank (such as a credit union or building society), an insurance enterprise or a registered securities dealer respectively **or investment activities carried on by an entity covered by clause 2(d) or a collection of investors comprising exclusively of entities covered by clause 2(d).** Such activities conducted by a person other than a **an entity covered by clause 2(d) or a collection of investors comprising exclusively of entities covered by clause 2(b),** bank (or financial institution agreed to by the Contracting States), insurance enterprise or registered securities dealer will not be considered to be the active conduct of a business, nor would they be considered to be the active conduct of a business if conducted by a bank (or financial institution agreed to by the Contracting States), insurance enterprise or registered securities dealer but not as part of the enterprise's banking, insurance or dealer business. Since a headquarters operation is in the business of managing investments, a company that functions solely as a headquarters company will not be considered to be engaged in the active conduct of a business for purposes of paragraph 3.

Note

There is a significant difference in the way a company manages its subsidiaries and the way Institutional Investors manage their assets. In the case of infrastructure and real estate there is no difference between the ways Institutional Investors carry out their activities and the way banks do.

49. No change proposed.

50. A business activity generally will be considered to form part of a business activity conducted in the State of source if the two activities involve the design, manufacture or sale of the same products or type of products, or the provision of similar services. The line of business in the State of residence may be upstream, downstream, or parallel to the activity conducted in the State of source. Thus, the line of business may provide inputs for a manufacturing process that occurs in the State of source, may sell the output of that manufacturing process, or simply may sell the same sorts of products that are being sold by the business carried on in the State of source. The following examples illustrate these principles:

> Example 1: ACO is a company resident of State A and is engaged in an active manufacturing business in that State. ACO owns 100 per cent of the shares of BCO, a company resident of State B. BCO distributes ACO's products in State B. Since the business activities conducted by the two companies involve the same products, BCO's distribution business is considered to form a part of ACO's manufacturing business.
>
> Example 2: The facts are the same as in Example 1, except that ACO does not manufacture products. Rather, ACO operates a large research and development facility in State A that licenses intellectual property to affiliates worldwide, including BCO. BCO and other affiliates then manufacture and market the ACO designed products in their respective markets. Since the activities conducted by ACO and BCO involve the same product lines, these activities are considered to form a part of the same business.
>
> **Example 3: An unlisted wholesale Real Estate Fund is set up to invest in real estate in France by an International Bank. All of its investors are either widely held pension funds or sovereign wealth funds. Each investor will have certain governance rights regarding the fund. A pension fund rather than holding the asset from outside of Europe will hold the interest in the Real Estate Fund either through a regional office of the pension fund in Europe or gives powers of management to an external manager who will act as a nominee for the Institutional Investor in the country in which the manager is based. The use of either the regional office or the external manager is to allow the pension fund to manage its governance rights in an efficient manner taking into account geography and time zones.**
>
> **On the assumption that the governance rights are material to the operation of the asset the activities of either the regional office or the manager will constitute an active business for the pension fund.**

51. No change proposed.

> Example **4**. CCO is a company resident of State C that operates an international airline. DCO is a wholly-owned subsidiary of CCO resident of State D. DCO operates a chain of hotels in State D that are located near airports served by flights operated by CCO. CCO frequently sells tour packages that include air travel to State D and lodging at DCO's hotels. Although both companies are engaged in the active conduct of a business, the businesses of operating a chain of hotels and operating an airline are distinct businesses. Therefore DCO's business does not form a part of CCO's business. DCO's business, however, is considered to be complementary to CCO's business because these two businesses are part of the same overall industry (travel) and the links between these activities tend to make them interdependent.

Example **5.** The facts are the same as in Example 3, except that DCO owns an office building in the other Contracting State instead of a hotel chain. No part of CCO's business is conducted through the office building. DCO's business is not considered to form a part of or to be complementary to CCO's business. They are engaged in distinct businesses in separate industries, and there is no economic dependence between the two operations.

Example **6.** ECO is a company resident of State E. ECO produces and sells flowers in State E and other countries. ECO owns all the shares of FCO, a company resident of State F. FCO is a holding company that is not engaged in a business. FCO owns all the shares of three companies that are resident of State F: GCO, HCO and ICO. GCO distributes ECO's flowers under the ECO trademark in State F. HCO markets a line of lawn care products in State F under the ECO trademark. In addition to being sold under the same trademark, GCO's and HCO's products are sold in the same stores and sales of each company's products tend to generate increased sales of the other's products. ICO imports fish from State E and distributes it to fish wholesalers in State F. For purposes of paragraph 3, the business of GCO forms a part of the business of ECO, the business of HCO is complementary to the business of ECO, and the business of ICO is neither part of nor complementary to that of ECO.

Example 7. JCO is a company resident of State J. JCO produces and sells baby food in State J and other countries. JCO acquires all the shares of KCO, a company resident of State K that produces and distributes jam and similar food products. JCO and KCO are both involved in the food industry, the products resulting from the businesses activities carried on by these companies are sold in the same stores and sales of each company's products would be affected by any incident related to the quality of any of their products. For purposes of paragraph 3, the business of KCO is complementary to the business of JCO.

Example 8. In the case of widely pension funds and sovereign wealth funds due to their size and range of investments sub paragraph (3)(b) is difficult to apply. If a pension fund resident in State E is using a regional office in State K to manage investments throughout an applicable region the fact the income of the regional office may be significantly less than the investment in State L (the investee market) should not prevent State L giving the pension fund the benefits of the DTA between State K and State L. Further if a pension fund or sovereign wealth fund resident in State E uses an external manager in State K to manage a holding vehicle established in State K to hold an investment in State L treaty benefits should not be denied. Pension funds and sovereign wealth funds manage their assets like banks and need to create holding entities which can exercise governance rights on a timely basis.

52. No change proposed.

53. No change proposed.

54. The determination of substantiality is made based upon all the facts and circumstances and takes into account the comparative sizes of the businesses in each Contracting State, the nature of the activities performed in each Contracting State, and the relative contributions made to that business in each Contracting State. In any case, in making each determination or comparison, due regard will be given to the relative sizes of the economies and the markets in the two Contracting States.

Example **9**. LCO is a pharmaceutical company resident of State L. LCO is engaged in an active manufacturing business in State L and also conducts research and development in State L. All the shares of LCO are owned by OCO, a company resident of State O. LCO has developed different anti-malaria drugs which are produced, under LCO's patents and trademarks, by MCO, a subsidiary of LCO which is a resident of State M. LCO sells these drugs, along with the other drugs that it manufactures, in State L and other States where malaria is almost non-existent. MCO pays a royalty to LCO for the use of the IP. Taking into account the nature of the business activities performed in State L and State M and the relative contribution made to the trade or business in each state, the royalty payment is entitled to treaty benefits. Due regard is also given to the relative small size of the market of anti-malaria drugs in State L (where the drugs are primarily sold to people who travel to parts of the world where malaria is widespread) compared to the market for such products in State M. Given the nature of the market for the drug in each country as well as all the other facts and circumstances, the business activity carried on by LCO in State L may be considered substantial in relation to the business activity carried on by MCO in State M.

Example **10**: PCO, a company resident of State P, a developing country, has developed a line of luxury cosmetics that incorporate ingredients from plants that are primarily found in State P. PCO is the owner of patents, trade names and trademarks for these cosmetics. PCO's shares are held in equal proportion by three shareholders: a company that is a resident of State P, another company that is a resident of State Q and a third company that is a resident of State R. PCO harvests and conditions the plants in State P. The plants are then shipped to State S (a large affluent country where there is an important demand for luxury cosmetics) where they are transformed into cosmetics by SCO, a subsidiary of PCO that is a resident of State S. The cosmetics are distributed in State S by another subsidiary, TCO, which is also a resident of State S, under trade names and trademarks licensed to TCO by PCO. The cosmetics are labelled "made in State S". Due to the relatively small size of the economy of State P compared to the size of the economy of State S, the business activity carried on by PCO in State P is substantial in relation to the business activity carried on by SCO and TCO in State S.

Example 11: A is a sovereign wealth fund resident in State S. State Y is on the other side of the world and has decided to privatise certain infrastructure assets. A has no regional office or asset manager based in State Y however ownership of infrastructure assets is subject to a number of government regulatory rules and A has governance rights over the assets dealing with maintenance, pricing and expansion of the facility. State X is where A manages all of its investments in State Y's part of the world. Therefore the investment in State Y will be made through State X. In examining the income of both States it is important to understand that the entity in State X will only have modest income as the capital for the investment will come from State A. Nevertheless provided that State X is where assets are managed from for that geographical region it is appropriate for State Y to grant the benefits of the DTA with State X to the investment entity resident in State X.

55. No change proposed.

56. No change proposed.

57. No change proposed..

Paragraph 4 − Derivative benefits

[4. A company that is a resident of a Contracting State shall also be entitled to a benefit that would otherwise be accorded by this Convention if, at the time when that benefit would be accorded:

> **a) at least 95 per cent of the aggregate voting power and value of its shares (and at least 50 percent of any disproportionate class of shares) is owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries, provided that in the case of indirect ownership, each intermediate owner is itself an equivalent beneficiary, and**
>
> **b) less than 50 per cent of the company's gross income, as determined in the company's State of residence, for the taxable period that includes that time, is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries, in the form of payments (but not including arm's length payments in the ordinary course of business for services or tangible property) that are deductible for the purposes of the taxes covered by this Convention in the company's State of residence.]**

58-61. ***Not quoted as not relevant***

Paragraph 5 − Discretionary relief

5. If a resident of a Contracting State is not entitled, under the preceding provisions of this Article, to all benefits provided under this Convention, the competent authority of the Contracting State that would otherwise have granted benefits to which that resident is not entitled shall nevertheless treat that resident as being entitled to these benefits, or benefits with respect to a specific item of income or capital, if such competent authority, upon request from that resident and after consideration of the relevant facts and circumstances, determines that the establishment, acquisition or maintenance of the resident and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under this Convention. The competent authority of the Contracting State to which the request has been made will consult with the competent authority of the other State before rejecting a request made under this paragraph by a resident of that other State.

62. No change proposed.

64. No change proposed.

65. No change proposed.

66. No change proposed.

67. No change proposed.

68. No change proposed.

Paragraph 6 − Definitions 6.

For purposes of the preceding provisions of this Article:

69. No change proposed.

The terms **"recognised stock exchange" , "principal class of shares", "disproportionate class of shares" and "primary place of management and control"** – ***Not quoted as not relevant***

70-76. ***Not quoted as not relevant***

The term "collective investment vehicle" ***Not quoted as not relevant***

77. No change proposed.

78. No change proposed.

The term "**equivalent beneficiary**" – subparagraph f)1 [f) the term "equivalent beneficiary" means a resident of any other State, but only if that resident i) A) would be entitled to all the benefits of a comprehensive convention for the avoidance of double taxation between that other State and the State from which the benefits of this Convention are claimed under provisions analogous to subparagraph a), b) or d), or subdivision i) of subparagraph c), of paragraph 2 of this Article, provided that if such convention does not contain a comprehensive limitation on benefits article, the person would be entitled to the benefits of this Convention by reason of subparagraph a), b), subdivision i) of subparagraph c), or subparagraph d) of paragraph 2 of this Article if such person were a resident of one of the Contracting States under Article 4 of this Convention; and B) with respect to income referred to in Articles 10, 11 and 12 of this Convention, would be entitled under such convention to a rate of tax with respect to the particular class of income for which benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention; or ii) is a resident of a Contracting State that is entitled to the benefits of this Convention by reason of subparagraph a), b) or d), or subdivision i) of subparagraph c), of paragraph 2 of this Article.] [Footnote 1: The inclusion of a definition of "equivalent beneficiary" will depend on whether paragraph 4 is included and whether that phrase is used in subparagraph f) of paragraph 2 dealing with collective investment vehicles.]

79. The definition of "equivalent beneficiary" is relevant for the purposes of the derivative benefits test in paragraph 4 but may also be relevant for the purposes of subparagraph f) of paragraph 2 depending on how that rule is drafted.

> **Note**
>
> This is highly complex and in our view will involve a distortion to collective investment. In example 3 we had a consortium of global Institutional Investors. If each of the investors had to fall within the definition of equivalent beneficiary then an investor who fell outside of that definition would be unable to bid for infrastructure assets or real estate assets on the same basis as other investors. Provided that the investment is actually managed from the relevant state it is difficult to understand why there would be concern on treaty shopping.

80. Under the definition, a person may qualify as an "equivalent beneficiary" in ~~two~~ **three** alternative ways.

81. No change proposed.

82. No change proposed.

82A. The third alternative would be relevant to pension funds and sovereign wealth funds. Provided that the investment vehicle is managed from the jurisdiction claiming the treaty benefits all pension fund and SWFs would qualify as "equivalent beneficiaries". This will need to be drafted after consultation.

83. No change proposed.

84. No change proposed.

85. ***Not quoted as not relevant***

Paragraph 7 – Entitlements to Benefits

7. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

Commentary on the PPT rule

1. No change proposed.

2. No change proposed.

3. No change proposed.

4. No change proposed.

5. No change proposed.

6. No change proposed.

7. No change proposed.

8. No change proposed.

9. No change proposed.

10. No change proposed.

11. No change proposed.

12. No change proposed.

13. No change proposed.

14. The following examples illustrate the application of the paragraph:

− Example A: T No change proposed.

− Example B: No change proposed.

− Example C: No change proposed.

− Example D: No change proposed.

− Example E: No change proposed.

-- Example F: A is a sovereign wealth fund resident in State S. State Y is on the other side of the world and has decided to privatise certain infrastructure assets. A has no regional office or asset manager based in State Y however ownership of infrastructure assets is subject to a number of government regulatory rules and A has governance rights over the assets dealing with maintenance, pricing and expansion of the facility. State X is where A manages all of its investments in State Y's part of the world. Therefore the investment in State Y will be made through State X. In examining the income of both States it is important to understand that the entity in State X will only have modest income as the capital for the investment will come from State A. Nevertheless provided that State X is where assets are managed from for that geographical region it is appropriate for State Y to grant the benefits of the DTA with State X to the investment entity resident in State X. As the decision to use a regional investment centre was based on geography and personnel paragraph 7 should not apply.

15. No change proposed.

18. No change proposed.

19 and ff. ***Not quoted as not relevant***.

7 Appendix B – Our Clients

7.1 Queensland Investment Corporation ("QIC")

QIC was established in 1991 by the Queensland Government to serve its long term investment responsibilities.

QIC's enabling legislation is the *Queensland Investment Corporation Act 1991 (Qld)*. QIC is also regulated by the Queensland State Government legislation pertaining to Government owned corporations, the *Government Owned Corporations Act 1993*, in addition to the *Corporations Act 2001*.

7.2 New Zealand Superannuation Fund ("NZ Super")

NZ Super is New Zealand's sovereign wealth fund. The NZ Super Fund is a New Zealand Government savings vehicle to help pre-fund the future cost of universal superannuation.

All New Zealanders aged 65 and over receive New Zealand Superannuation payments. These payments are paid by today's Taxpayers. Over the next few decades, however, the New Zealand population will age significantly.

To take the pressure off future New Zealand Taxpayers and in response to the challenge of New Zealand's ageing population, the *NZ Superannuation and Retirement Income Act 2001* established:

- the New Zealand Superannuation Fund ("Fund"), a pool of assets on the Crown's balance sheet; and
- the Guardians of New Zealand Superannuation, a Crown entity charged with managing the Fund.

The Guardians of New Zealand Superannuation is the Crown entity charged with managing and administering the Fund. It operates by investing initial Government contributions – and returns generated from these investments – in New Zealand and internationally, in order to grow the size of the Fund over the long term.

8 Appendix C

8.1 Sovereign Wealth Funds and Public Pension Reserve Funds

Sovereign Wealth Funds (SWFs) are pools of assets owned and managed directly or indirectly by governments to achieve national or State objectives. They may be funded by:

i) foreign exchange reserves;

ii) the sale of scarce resources such as oil; or

iii) general tax and other revenue.

There are a number of potential objectives of SWFs, which are not always easy to attribute to a particular fund; and some funds may have more than one of the distinguishable objectives. Some of these are:

i) to diversify assets;

ii) to get a better return on reserves;

iii) to provide for pensions in the future;

iv) to provide for future generations when natural resources run out;

v) price stabilisation schemes;

vi) to promote industrialisation; and

vii) to promote strategic and political objectives.

Public Pension Reserve Funds (PPRFs) could be defined as funds set up by governments or social security institutions with the objective of contributing to financing the relevant pay-as-you-go pension plans.

i. The first type, Social Security Reserve Funds (SSRFs), is set up as part of the overall social security system, where the inflows are mainly surpluses of employee and/or employer contributions over current payouts, as well as, in some cases, top-up contributions from the government via fiscal transfers and other sources. Among others, Denmark’s Social Security Fund, Japan’s Government Pension Investment Fund, and USA’s Social Security Trust Fund fall within this category.

ii. The second type, Sovereign Pension Reserve Funds (SPRFs), refers to those funds which are established directly by the government (completely separated from the social security system), and its financial inflows are mainly from direct fiscal transfers from the government. Unlike the first type of reserve fund, those within this category have been set up by governments to finance public pension expenditures at specific future date. Some are not allowed to make any payouts for decades. Examples include, the New Zealand Superannuation Fund, the Irish National Pension Reserve Fund, the Norwegian Government Pension Fund, and the French Fonds de réserve pour les retraites. Some of these funds are sometimes treated as SWFs and indeed a few fit both definitions.

9 Appendix D – Australian MIT rules and FATCA

9.1 Australian Managed Investment Trust ("MIT") rules - overview

Australia's MIT rules offer significant tax concessions for entities which qualify as a MIT. Concessions are available for both foreign residents and Australian residents and allow:

- foreign residents to access a reduced rate of withholding tax on most distributions (currently 15% and in some limited cases 10% - the general rate is 30%); and
- Australian residents to access the capital gains tax discount on capital gain distributions.

The types of trusts which qualify as MITs are widely held Australian resident and managed trusts which carry on passive investment activities (e.g., investing in Australian rental property).

A key requirement for a trust to qualify as an MIT is that it must be 'widely held'. Institutional Investors are, in many cases, able to satisfy this requirement as they are deemed to be widely held. Recent amendments to the MIT rules seek to include the following as entities that can satisfy the requirements for MIT status[22]:

- a Managed Investment Scheme ("MIS") that is not required to be registered under the Corporations Act because it provides financial services to wholesale clients;
- a MIS that is unable to register under the Corporations Act because it is operated by a government-owned entity or a wholly-owned subsidiary of government-owned entity; and
- a MIS that is operated or managed by an entity that is not required to be a financial services licensee because it is government-owned.

These changes are being introduced to recognise current practices by Institutional Investors, which often use collective investment vehicles to invest into assets in Australia.

> *"These conditions were designed to ensure that the trust was a genuine collective investment vehicle and to limit the ability of foreign residents to adopt trust structures to access the reduced withholding tax rates.*
>
> *However, genuine collective vehicles that were not registered under the Corporations Act, and were not required to be registered (certain wholesale MISs and government-owned MISs), could not satisfy that MIT definition.*
>
> *The amendments extend the definition of MIT to enable certain wholesale MISs and government-owned MISs to qualify as MITs. This is to ensure that the MIT withholding*

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[22] https://www.ato.gov.au/Business/International-tax-for-businesses/In-detail/Investing-in-Australia/Amendments-to-the-definition-of-Managed-Investment-Trust/?page=3 – accessed 29 December 2014

tax rules apply consistently to all widely held collective investment vehicles undertaking passive investments."[23]

9.2 *United States ("US") Foreign Account Tax Compliance Act ("FATCA") - overview*

FATCA is legislation enacted by US Congress to prevent offshore tax abuses by US persons. These rules are intended to be wide-ranging and force global financial institutions, investment entities, as well as national banks and other financial organizations to report details on their US clients directly to the US Internal Revenue Service ("IRS").

> *"The fundamental premise of FATCA is that a Foreign Financial Institution (FFI) will be subjected to a 30 percent rate of withholding on all withholdable payments (generally US fixed, determinable, annual or periodical income (FDAP) as well as the gross sales proceeds on sales of assets that generate US source interest or dividends) unless the FFI enters into an agreement with the IRS and agrees to identify certain US persons and to report them annually to the IRS. Non-US pension funds will generally be FFIs for these purposes because of their investment activities."*[24]

The FATCA regulations recognise the unique role of pension and sovereign wealth funds and have provided broad based exemptions for these classes of investors on the basis that they present a low risk of tax evasion.[25] These Institutional Investors would have otherwise been caught by FATCA and classified as FFI's due to their investment activities.

The specific classes of entities that are exempt from registering and reporting are:

- most governmental entities;
- most non-profit entities; and
- certain retirement entities, such as pension funds.

Retirement funds which qualify for the exemption include those established in a country with which the U.S. has an income tax treaty in force and which are generally exempt from income taxation in that country. Pension plans or other retirement arrangements that are established in the U.K. or Australia, for example, are excluded as FFIs and are thus not required to trace their ownership to identify US members or potential US members.

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[23] https://www.ato.gov.au/Business/International-tax-for-businesses/In-detail/Investing-in-Australia/Amendments-to-the-definition-of-Managed-Investment-Trust/?page=2#Why_change_MIT_ - accessed 29 December 2014

[24] http://www.kpmg.com/Ca/en/IssuesAndInsights/ArticlesPublications/Documents/FATCA-Challenges-and-Insights-for-Pension-Funds-V2.pdf - accessed 29 December 2014

[25] http://www.irs.gov/pub/newsroom/reg-121647-10.pdf - accessed 29 December 2014