Summary

This note is presented FOR DISCUSSION (and not for approval) at the nineteenth session of the Committee to be held in Geneva on 15-18 October 2019.

The note includes an analysis of tax policy issues related to the treatment, under tax treaties, of various types of collective investment. It is intended to serve as an introduction to the subsequent discussion of various proposals for changes to the United Model Tax Convention aimed at ensuring that tax treaties deal appropriately with these issues.

Based on the discussion of this note at the Committee’s meeting of 15-18 October 2019 and on subsequent written comments, the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries intends to present, at the twentieth session of the Committee (in April 2020) a series of proposals for changes to the Commentary of the UN Model that will address various issues related to the tax treatment of collective investment.
1. At its sixteenth session (New York, 14-17 May 2018), the Committee discussed note E/C.18/2018/CRP.7 on the treatment of collective investment vehicles. It was then agreed that further work on that issue should be carried out under the umbrella of the Subcommittee on Updating the United Nations Model Convention.

2. At its seventeenth session (Geneva, 16-19 October 2018), the Committee discussed follow-up note E/C.18/2018/CRP.10 which described various tax treaty issues that arose with respect to the application of tax treaties to CIVs. It was then suggested that, given the importance of investment by collective investment vehicles in emerging economies, it would be important to address those issues from the perspective of the United Nations Model Double Taxation Convention between Developed and Developing Countries, focusing on questions related to the following:

   a) Treaty residence of collective investment vehicles and the granting of treaty benefits to them and their members;
   b) Possibility of the collective investment vehicles claiming treaty benefits on behalf of their members;
   c) Application of limitation-on-benefits rules (art. 29) to collective investment vehicles;
   d) Granting of benefits in the case of members who are equivalent beneficiaries;
   e) Development of alternative treaty provisions dealing with those issues.

3. At its meeting of April 2019, the Subcommittee on Updating the United Nations Model Double Taxation Convention between Developed and Developing Countries agreed that a good starting point for further work on the above issues would be a note that would explore the various policy issues that developing countries should consider when addressing the application of tax treaties to different forms of collective investment. The Secretariat was asked to prepare a note that would briefly describe these policy issues for discussion at the next meeting of the Committee.

4. This note has been prepared by the Secretariat pursuant to the decision of the Subcommittee. It describes and analyses the most important tax treaty issues that arise with respect to collective investment. The Committee is invited to discuss this note at its nineteenth session (15-18 October 2019) and to ask Committee members and country observers wishing to send written comments on this note to do so by email to the Secretariat at taxcommittee@un.org before 31 January 2020.

5. In light of the discussion of this note by the Committee and the subsequent written comments, the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries intends to present, at the twentieth session of the Committee (in April 2020) a series of proposals for changes to the Commentary of the UN Model Convention that will address various issues related to the tax treatment of collective investment.
A. Collective investment vehicles

6. As indicated in note E/C.18/2018/CRP.7, a collective investment vehicle (CIV) can be defined as a fund that pools the investment of many investors and is therefore widely-held, holds a diversified portfolio of securities and is subject to investor-protection regulation in the country in which it is established. This note deals with collective investment vehicles separately from pension funds, real estate investment trusts and so-called “non-CIVs” even though all these are used for collective investment (i.e. the pooling of investments by a group of investors).

1. Should a developing country include provisions on collective investment vehicles in its tax treaties?

7. The first policy issue that a developing country should address in relation to the application of tax treaties to CIVs is whether it should seek to deal with CIVs in its tax treaties. Apart from a passing reference to collective investment vehicles in Article 29 (Entitlement to treaty benefits), the articles of the UN Model, like those of the OECD Model, do not address expressly CIVs and few treaties actually include specific provisions related to CIVs. The Commentary on Article 1 of the OECD Model, however, includes a long discussion of the tax treaty treatment of collective investment vehicles.2

8. A developing country might consider that since CIVs are not widely used by its own residents, any specific provision related to CIVs would only benefit foreign investors. It should recognize, however, that CIVs constitute one of the largest categories of investors in foreign capital markets and that, if it wants to encourage portfolio investment on its territory, it would be useful to clarify whether and how tax treaties will apply to such investment. Without such clarification, foreign CIVs may be reluctant to invest in a country or, if they do invest, the tax administration may have to address difficult treaty issues without a clear indication of the policy that the country has adopted in relation to foreign CIVs. Such clarification would be particularly important for emerging economies that want to encourage foreign investors to invest in their capital markets.

9. A developing country should also consider whether treaty-shopping concerns could arise with the use, by investors of third states, of collective investment vehicles established in states with which it concludes treaties.

10. Countries should note, however, that while such issues may be addressed through treaty provisions, they may also be addressed through domestic legislation, unilateral administrative guidance or through a mutual agreement adopted under paragraph 3 of Article 25 (Annex 1

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1 At page 1.
2 Paragraphs 31 to 48 of the Commentary, which reflect the conclusions of the 2010 OECD report “The granting of treaty benefits with respect to the income of collective investment vehicles”, reproduced at page R24-(1) of the full version of the OECD Model.
includes the example of such a mutual agreement on CIVs concluded between the Netherlands and Switzerland).

2. **Tax treaty entitlement of CIVs**

11. CIVs adopt different legal structures and may be set up, for instance, as companies, partnerships, trusts or contractual arrangements that create a joint ownership. Also, as indicated in note E/C.18/2018/CRP.7, a general policy goal of many countries is to ensure that investing through a domestic CIV should result in tax burden that is equal to the one that applies in the case of a direct investment, i.e. an investment where the CIV would not exist and where the investor in the CIV would have acquired directly its share of the assets held by the CIV. That policy goal is achieved through different mechanisms that result in tax being paid exclusively either at the level of the CIV or at the level of the investors:

   a) *The CIV may be set up, or treated for tax purposes, as a transparent entity:* for instance, if the state where the CIV is set up treats partnerships or some trusts as transparent for tax purposes and taxes directly the partners (in the case of a partnership) or beneficiaries (in the case of a trust), no tax will be payable by the CIV and each investor in the CIV will pay tax on its respective share of the income derived through the CIV.

   b) *The CIV may be set up as a contractual arrangement that does not create a separate entity:* in such case, the CIV is not a separate taxpayer and each investor in the CIV is considered to be a joint owner of the assets held through the CIV and is taxed on its share, as joint owner, of the investment income derived from these assets.

   c) *The tax law provides that CIVs are taxed on their income and that investors are not taxed on distributions by the CIV:* in that case taxation takes place exclusively at the level of the CIV.

   d) *The tax law provides that CIVs are taxed on their income but that distributions to the CIV investors are deductible from their tax base:* in that case, while the CIV is technically taxable on its investment income, it does not, in fact pays tax to the extent that it distributes the income that it has earned.

   e) *The tax law provides that CIVs are taxed on their income but that investors get a credit for the tax paid by the CIVs:* in that case, the tax paid by the CIV reduces the tax that the investor has to pay when it is taxed on the income from the CIV (e.g. upon distribution of that income).

12. The different legal structures and tax treatment of CIVs in the states in which they are established raise a number of technical issues as regards the application of the typical provisions of tax treaties.

13. First, is the CIV a person to which a treaty may apply? This may be the case for vehicles that constitute separate entities, such as company and a partnership, may not be the case for vehicles

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3  At page 3.
4  These issues are discussed at pages 4-5 of note E/C.18/2018/CRP.7.
such as a contractual arrangement (such as a “fonds commun de placement”) and a trust (depending on the treaty definition of “person” and the domestic tax treatment of trusts).

14. Second, does the CIV qualify as a “resident of a Contracting State”? Assuming that a CIV falls within the treaty definition of a “person” and having regard to the various mechanisms described in paragraph 11 above, it is not entirely clear that all states would agree that a CIV would be considered to be “liable to tax” in the situations described in cases c), d) and e).

15. Third, if the respective domestic laws of the two states take different views as to the tax treatment of the CIV (e.g. where one state considers the entity as fiscally transparent while the other treats it as a taxpayer) and the relevant treaty does not include the transparent entity provision of Art. 1(2) of the UN Model, it is not clear how the treaty reliefs would be applied to the income derived through the CIV.

16. Fourth, assuming that the CIV qualifies as a “resident of a Contracting State” under the relevant treaty, it is unclear whether all countries would consider it to be the beneficial owner of its income, especially if almost all that income must contractually be distributed to investors.

17. Despite the legal analysis, however, the basic policy question that any country should address is whether treaty benefits should be granted to CIVs and if yes, under which conditions. If CIVs exist in different forms in each of the two states that have concluded a tax treaty, it would seem inappropriate to leave the issue of the treaty entitlement of each CIV to a purely legal analysis to the extent that this could result in most of the CIVs established in one state being entitled to treaty benefits while most of the CIVs established in the other state are not.

18. Another set of policy issues arise where a CIV does not, in its own right, qualify as a resident of Contracting State. In that situation, the first question is whether and how treaty benefits may be claimed at the level of each investor, which may result in the application of a number of different tax treaties if the investors reside in different states. If it is recognized that each investor is entitled to treaty benefits on its share of the relevant income, it would be necessary to consider whether the CIV could claim these benefits on behalf of the investors, which would seem to be the most practical way of ensuring that treaty benefits are effectively granted.

19. A subsidiary policy issue that arises with respect to the treaty entitlement of CIVs is whether they present treaty-shopping risks and how to deal with such risks. Even if it is concluded that a CIV qualifies as a resident of a Contracting State, the application of the anti-treaty shopping rules of paragraph 1 to 7 of Article 29 of the UN Model without any specific provisions for CIVs will mean that CIVs with a majority of foreign investors will be denied treaty benefits, which will likely affect the CIVs established in some small open economies more than it will CIVs established in larger countries.

20. This issue is raised in subparagraph g) of paragraph 2 of Article 29 (Entitlement to treaty benefits) of the UN Model, which merely provides a placeholder for a “possible provision on collective investment vehicles”. Paragraph 17 of the Commentary on Article 29 explains that reference as follows:
17. Countries wishing to provide a rule addressing the entitlement to benefits of “collective investment vehicles” could include such a rule as subparagraph g) of paragraph 2. The inclusion of such a rule could be a useful tool to facilitate foreign portfolio investment, although in drafting any such rule, countries should aim not to create opportunities for treaty shopping through the use of collective investment vehicles.

21. The Commentary of the OECD model goes further and explains why a specific rule dealing with collective investment vehicles may be needed in Article 29:5

… a specific rule will frequently be needed since a CIV may not be entitled to treaty benefits under either the other provisions of paragraph 2 or under paragraphs 3, 4 or 5 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;
- the distributions made by the CIV are deductible payments;
- the CIV is used for investment purposes rather than for the “active conduct of a business” within the meaning of paragraph 3;
- the CIV does not meet the ownership test of paragraph 4, and
- the CIV does not qualify as a headquarters company under paragraph 5.

B. Pension funds

22. Given the importance of investment by pension funds, which are used in many countries to collectively manage and invest the retirement savings of large numbers of individuals, developing countries should consider the following policy issues related to domestic investments by foreign pension funds even if they do not have important pension funds established on their territory:

1. Whether foreign pension funds should be entitled to treaty benefits.
2. Whether and to what extent the income of pensions funds should be exempt from source taxation.

1. Tax treaty entitlement of pensions funds

23. A number of states encourage retirement savings through tax incentives provided to contributions made to pension funds. These incentives often take the form of a tax deferral with the result that, subject to strict conditions and to monetary limits, the part of the income of an individual that is contributed to a pension fund, the contributions made by an employer as well as the income earned by the pension fund on the investment of these contributions are exempt from tax until pension benefits are paid by the pension fund. At that time, the pension benefits are fully subject to tax.

24. As a result, pension funds typically do not pay tax in the state in which they are established on the income derived from the investment of the contributions that they receive. The different legal forms that pension funds can take and the different mechanisms that are used to ensure that

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5 Paragraph 55 of the Commentary on Article 29 of the OECD Model. Paragraphs 56 to 67 of that Commentary offer different alternative versions of a rule addressing treaty-shopping and CIVs.
their investment income is exempt from tax until it is distributed as pension benefits raise the issue of whether pension funds can be considered to be “liable to tax”, which is a requirement for being a “resident of a Contracting State” under the wording of paragraph 1 of Article 4.

25. This issue is dealt with in paragraph 6 of the Commentary on Article 4 of the UN Model, which quotes the following two paragraphs from the Commentary of the 2014 OECD Model:

8.6 Paragraph 1 refers to persons who are “liable to tax” in a Contracting State under its laws by reason of various criteria. In many States, a person is considered liable to comprehensive taxation even if the Contracting State does not in fact impose tax. For example, pension funds, charities and other organisations may be exempted from tax, but they are exempt only if they meet all of the requirements for exemption specified in the tax laws. They are, thus, subject to the tax laws of a Contracting State. Furthermore, if they do not meet the standards specified, they are also required to pay tax. Most States would view such entities as residents for purposes of the Convention (see, for example, paragraph 1 of Article 10 and paragraph 5 of Article 11).

8.7 In some States, however, these entities are not considered liable to tax if they are exempt from tax under domestic tax laws. These States may not regard such entities as residents for purposes of a convention unless these entities are expressly covered by the convention. Contracting States taking this view are free to address the issue in their bilateral negotiations.

26. Given the uncertainty resulting from the two opposite views reflected in these paragraphs and in light of the importance of cross-border investment by pension funds, the OECD decided, in 2017, to modify paragraph 1 of Article 4 to provide expressly that a “recognized pension fund”, as defined in a new subparagraph 1 (i) of Article 3 (General definitions), is a resident of the state in which it is established.

27. These changes have yet to be considered by the UN Committee. The policy question that arises for the Committee and for developing countries is therefore whether it would be appropriate to generally provide that pension funds, as defined for that purpose, qualify as “resident of a Contracting State”. If there were no agreement to do so, the next policy question would be whether and how to reconcile the opposite views reflected in paragraphs 8.6. and 8.7 above so as to provide greater certainty as regards cross-border investment by pension funds.

28. As in the case of CIVs, a subsidiary policy issue that arises with respect to the treaty entitlement of pension funds is whether they present treaty-shopping risks and how to deal with such risks. This issue is addressed in subparagraphs e) (ii) and (iii) of paragraph 2 of Article 29 (Entitlement to treaty benefits) of the UN Model. The general thrust of these subparagraphs is to subject the entitlement to treaty benefits of a “registered pension fund” to the condition that more than 50 per cent of the beneficial interests in the fund are owned by individuals resident of either Contracting State or of a third state where the residents of that third state are entitled to similar benefits. Paragraph 14 of the Commentary on Article 29, however, reflects the uncertainty concerning the question of whether pension funds constitute “residents of a Contracting State” under the UN Model and provides as follows:

Not all States include within the scope of their tax conventions recognized pension funds. Those States should, in their drafting of Article 29, therefore delete clauses (ii) and (iii) of subparagraph e).
However, States that wish to clarify the application of a tax convention to recognized pension funds may wish to define the term “recognized pension fund” in Article 3. Such definition could be drafted along the following lines [the definition that follows is similar to that included in Article 3(1)i) of the 2017 OECD Model].

2. **Source tax exemption for the income of pensions funds**

29. Paragraph 18 of the Commentary on Article 18 of the UN Model quotes paragraph 69 of the Commentary on Article 18 of the OECD Model (2014), which includes the following suggested provision exempting income derived by pension funds from source taxation:

   Notwithstanding any provision of this Convention, income arising in a Contracting State that is derived by a resident of the other Contracting State that was constituted and is operated exclusively to administer or provide pension benefits and has been accepted by the competent authority of the first-mentioned State as generally corresponding to a pension scheme recognised as such for tax purposes by that State, shall be exempt from tax in that State.

30. As indicated in that paragraph, that provision could be included in a treaty between two states which, under their domestic law, exempt from tax income of pension funds established in their territory if these States wished “to achieve greater neutrality with respect to the location of capital”.

31. The reason why such a provision would likely ensure “greater neutrality with respect to the location of capital” is that if income derived by a pension fund is exempt from tax where derived from the territory of the state in which the pension fund is set up but is taxed at source where derived from another state, the pension fund will logically favor an investment in the former state as long as the return on investment is comparable in the two states. For instance, if a pension fund established in state A can obtain an annual tax-free interest of 3% from investing in bonds of publicly-listed companies of state A but would be subject to a 10% withholding tax on similar interest derived from state B, all other things being equal, it would not invest in bonds issued by companies in state B that would also pay 3% interest since the after-tax interest earned by the pension fund would be 2.7%. This would discourage pension funds of state A from diversifying their investments by investing part of their assets abroad, a tax-distortion that could detrimental to both the pensioners of state A and the capital markets of state B.

32. In recent treaties, a few developing countries (e.g. Brazil, Chile and Vietnam) have agreed to exemptions for income derived by pension funds. Other developing countries might be concerned, however, that as long as there are no important pension funds established in their territory.

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6 Including any potential capital gain on the alienation of the bond which would typically be exempt from source taxation under provisions similar to paragraph 6 of Art. 13 (Capital Gains) of the UN Model.
7 See paragraph 3 of Article 10 (Dividends) and sub-paragraph 4 c) of Article 13 (Capital Gains) of the Chile-Japan treaty (2016).
8 See sub-paragraph 3 a) of Article 10 (Dividends) and sub-paragraph 3 a) of Article 11 (Interest) of the Brazil-Switzerland treaty (2018, not yet in force).
9 See paragraph 4 of the Protocol to the Vietnam-United States treaty (2015, not yet in force).
countries and their capital markets are small, such exemptions would not provide reciprocal benefits to the two contracting states.

33. A state that would agree to such an exemption for pensions funds established in another state should ensure that the meaning of the term “pension fund” is clear so as to avoid situations where the exemption would be requested for investments though vehicles that would arguably be set up to provide a pension to one or more individuals but that would not be registered or recognized as such in the state of residence. One way of doing so would be to refer to the income of a “recognized pension fund” and to include the definition of that term in the 2017 OECD Model.

34. Also, the scope of the provision suggested in paragraph 69 of the Commentary on Article 18 of the OECD Model is very broad as it applies to any income that a pension fund could derive from a state. Many countries would, however, be reluctant to allow an exemption for the income that a pension fund would derive from the direct ownership of assets such as mining rights or from carrying on business through a permanent establishment. This is why a number of treaties provide a narrower exemption that is limited to passive income such as dividends, interest and capital gains on certain shares.

3. Taxation of an individual on that individual’s share of the income of a pension fund

35. Another tax treaty issue that arises with respect to the investment income of pension funds is that of the possible taxation, in the hands of the pensioners or future pensioners, of their share of the investment income earned by the pension fund.

36. Assume, for example, that a resident of state A who is now retired worked all her career in state B where she contributed to a pension fund. After her retirement, she receives a pension each month but her previous contributions, which are still managed by the pension fund, continue to generate investment income.

37. According to the domestic law of some countries, the investment income of residents is taxed even if such income is earned through foreign entities in which these individuals participate and is not distributed immediately to these individuals. This may be the result of so-called “foreign investment fund” rules or of other rules intended to prevent resident taxpayers from using foreign investment entities to avoid taxation on their investment income.

38. The taxation of a resident pensioner or future pensioner on that individual’s share of the investment income of a foreign pension fund would seem unjustified where resident taxpayers are generally exempt on the investment income generated by pension funds established in their own
state of residence as it unduly penalizes residents who worked abroad and, therefore, have contributed to foreign pension funds. Such taxation could also result in economic double taxation if the same investment income, when subsequently distributed as part of a pension, is fully taxed in the hands of the pensioner.

39. Some tax treaties expressly address that issue by preventing a state from taxing a resident on that resident’s share of the investment income of a foreign pension fund as long as that income is not distributed. This is the case of paragraph 1 of Article 19 (Pension Funds) of the Vietnam-United States treaty (2015, not yet in force), which reads as follows:

Where an individual who is a resident of a Contracting State is a member or beneficiary of, or participant in, a pension fund established in the other Contracting State, income earned by the pension fund may be taxed as income of that individual only when, and, subject to paragraph 1 of Article 18 (Pensions, Social Security, Annuities, Alimony, and Child Support) of this Agreement, to the extent that, it is paid to, or for the benefit of, that individual from the pension fund (and not transferred to another pension fund in that other Contracting State in a transfer that qualifies as a tax-deferred transfer under the laws of that other Contracting State).

40. Other treaties address the issue through provisions similar to the suggested provision discussed in paragraph 31-69 of the Commentary on Article 18 of the OECD Model (2014), as quoted in paragraph 18 of the of the Commentary on Article 18 of the UN Model. That suggested provision deals not only with the deductibility of pension contributions made to a foreign pension fund but also with the issue of the taxation, in the hands of the individual, of the investment income derived from the contributions made to a foreign pension fund by both the employee and the employer.

41. It is not uncommon for employees from foreign countries to spend significant time working in developing countries and even becoming residents of these countries for tax purposes. To the extent that these employees have rights in foreign pension funds, this issue related to the taxation of their share of the investment income in these funds may need to be addressed in tax treaties.

C. Real Estate Investment Trusts (REITs)

42. A large number of countries have in their legislation rules that facilitate collective investment in immovable property. This includes a number of emerging economies (Brazil, India, Malaysia and South Africa, for example). These rules typically avoid taxation at the level of the entity used to pool the investment of a large number of small investors and ensure that the income is taxed at the level of the investors. Entities used for that purpose are commonly referred to as real estate investment trusts (REITs).

43. A REIT is an investment vehicle that generally derives its income primarily from long-term investment in immovable property (real estate), distributes most of that income annually and does not pay income tax on income related to immovable property that is so distributed. Despite the reference to “trust” (which comes from the structure adopted by REITs when they were first used in the United States in the 1960s), a REIT may be legally organized as a company, partnership, trust or contractual arrangement. Some widely-held REITs are regulated as collective investment vehicles but others are not.
44. The tax policy issues related to the application of tax treaties to REITs have been analyzed in the 2008 OECD Report entitled “Tax Treaty Issues Related to REITs”.12

45. The main source of income that a foreign REIT would derive from a country is rental income derived from immovable property that would be covered by Article 6 (Income from immovable property) of the UN Model. A foreign REIT could also derive capital gains from immovable property or securities that would be covered by Article 13 (Capital gains). Other income of a foreign REIT may be business profits falling under Article 7 (Business profits) (e.g. where the REIT derives income from businesses carried on through immovable property such as a hotel), dividends covered by Article 10 (Dividends), interest (mostly from mortgages) covered by Article 11 (Interest) as well as other types of income.

46. Under these provisions, the income derived by a foreign REIT would typically be taxable in the country of source. Given their legal structure and the mechanisms used to ensure a single level of tax, however, foreign REITs could face the same issues as those that foreign collective investment vehicles could face as regards their entitlement to treaty benefits (see paragraphs 11 to 17 above). Also, where the treaty applies at the level of the investors rather than at the level of the REIT, the same practical issues would arise concerning the application of the treaty to a large number of taxpayers (see paragraph 18 above).

47. The main policy issues related to the application of a tax treaty to REITs, however, would arise with respect to the taxation of the income that foreign investors would derive from their participation in a domestic REIT. Where a REIT is established as a company, these foreign investors would likely be considered to receive dividends covered by Article 10 whereas in the case of REITs set up as contractual arrangements or trusts, the income derived by the REITs would likely keep its nature (e.g. income from immovable property, interest or business profits) when taxed directly in the hands of the foreign investors.

48. Regardless of this legal analysis, the treaty policy issue that arises is whether the income derived by foreign investors through a domestic REIT should be treated as income from immovable property (subject to unlimited source taxation under article 6) or income from investing in a security (subject to limited source taxation under Article 10).

49. Having analyzed this issue, the OECD concluded that:

   … an appropriate treaty policy would be to treat a REIT distribution to a small investor in the same way as a portfolio equity investment. It also concluded, however, that limiting the rate of source taxation to that applicable to portfolio dividends would not be appropriate in the case of an investor holding a large investment in a REIT. For such a large investor, the investment in the REIT may be a substitute for a direct investment in the underlying property of the REIT. In this situation, limiting the source State tax on distributions from the REIT to

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12 Reproduced at page R(23)-1 of the full version of the OECD Model Tax Convention, which resulted in a few changes to the Commentary on Article 10 of the OECD Model.
the reduced rate applicable to portfolio dividends or the even lower rate applicable to direct dividends would seem inappropriate; such distributions should be subjected to the full tax rate provided by domestic law.13

50. As indicated in the OECD report, implementing the above policy conclusion would require the inclusion of specific provisions in a tax treaty.

51. Developing countries that have introduced REIT regimes in their domestic law or that are considering doing so should consider whether this policy conclusion is appropriate in their circumstances and whether such provisions should be included in their treaties. They should, in particular, consider the conclusion that distributions to a foreign investor that holds a large participation in a domestic REIT set up as a company should not be entitled to the reduced rate applicable to portfolio dividends or the even lower rate applicable to direct dividends under paragraph 2 of Article 10 of the UN Model.

52. Another policy issue related to the application of tax treaties to foreign investors in a domestic REIT arises when the foreign investor realizes a gain upon the alienation of its interest in such a REIT. Since the main assets held by a REIT are immovable property, it is likely that the provisions of paragraph 4 of Article 13 would apply upon the alienation of interests in a REIT set up as company, partnership or trust (whereas the provisions of paragraph 1 of Article 13 would apply in the case of a REIT set up as a contractual arrangement). As explained in the OECD Report,14 some countries consider that result to be entirely consistent with the purpose of paragraphs 1 and 4 of Article 13, while other countries consider that a small investor’s interest in a REIT should be treated as a gain on a security not covered by paragraphs 1 and 4 of Article 13 because that would be more consistent with the policy view that distributions from a REIT should be treated as portfolio dividends and because it would be very difficult to administer the application of source taxation of capital gains on small interests in a widely held REIT.

53. Developing countries that have introduced REIT regimes in their domestic law or that are considering doing so should consider these two different policy views when determining how gains on the alienation, by a foreign investor, of interests in a domestic REIT should be dealt with in their treaties.

D. “Non-CIVs”

54. The term “non-CIV” was coined by the OECD to refer to investment funds that are similar to CIVs but do not qualify as such under the definition in paragraph 6 above because, for instance, they are not regulated (since they only involve institutional investors such as banks, insurance companies, pension funds etc. which do not require investor protection) or because they do not hold a diversified portfolio of securities. A “non-CIV” would include, for instance, a private equity fund set up as a limited partnership in order to acquire specific assets, such as all the shares of an under-performing publicly-listed company, with the limited partners being institutional partners that provide most of the capital and the general partner being the specialized investment firm that

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13 At paragraph 27 of the Report.
14 Paragraphs 39 to 42 of the Report.
set up and manages the fund. It could also include a venture capital fund that would be similarly structured to seek private equity participations in start-up enterprises with growth potential.

55. While non-CIVs raise many of the same treaty issues as CIVs, countries have been less inclined to clarify how treaties would apply to them. Nevertheless, since the application of anti-treaty-shopping rules is a particular concern for non-CIVs with investors in many different countries, example M included in the Commentary on the general treaty anti-abuse rule of paragraph 9 of Article 29 of the UN Model and OECD Model presents a situation where the rule should not apply to a non-CIV. No specific exception has been provided, however, with respect to the anti-treaty shopping rules of paragraphs 1 to 7 of Article 29 of the UN Model.

56. One specific issue that often arises with respect to non-CIVs (but which can also arise with respect to CIVs) is whether the location of the fund’s key employees outside the state where the fund is established (e.g. in the case of a venture capital fund, in order to provide advice to the enterprises in which the fund has invested) constitutes a permanent establishment for the fund itself. In order to provide certainty in this area and to attract foreign investors to locally managed funds, a few countries have unilaterally clarified that they would not consider that the activities of a local fund manager would constitute a permanent establishment for foreign investors.  

57. Given that non-CIVs are generally not addressed in existing tax treaties and in the UN and OECD models (except as indicated in paragraph 55 above), there does not seem to be strong policy reasons for a developing country to include in its tax treaties specific provisions dealing with non-CIVs.

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ANNEX 1

Mutual agreement between the Netherlands and Switzerland concerning the application to CIVs of the 2010 treaty between these countries

Preamble

The competent authorities of Switzerland and the Netherlands (hereinafter: ‘the competent authorities’) have reached the following mutual agreement regarding the application of the Convention between the Kingdom of the Netherlands and the Swiss Confederation for the avoidance of double taxation with respect to taxes on income signed at The Hague on February 26th, 2010 and the related Protocol (‘the Convention’) with respect to a Netherlands fiscal investment institution (fiscale beleggingsinstelling, ‘FBI’), by a Swiss contractual fund (fonds commun de placement, FCP’) and a Swiss open ended investment fund (société d’investissement à capital variable, ‘SICAV’). This Competent Authority Agreement (‘Agreement’) is entered into under Article 25, paragraph 3 (Mutual Agreement Procedure) of the Convention.

Purpose of the Agreement

The competent authorities consider that difficulties or doubts may arise as to the application of the provisions of the Convention on items of income received by a FBI, a SICAV and a FCP (abbreviated ‘CIVs’).

In this respect reference is made to the issues raised in paragraphs 6.17 to 6.20 of the OECD Commentary on Article 1 of the OECD Model Tax Convention (as it read on 15 July 2014). The purpose of this Agreement is to clarify the application of the provisions of the Convention and to establish accompanying procedures with respect to refund of withholding taxes on items of income received by the above mentioned CIVs.

The competent authorities agree that in principle the entitlement to treaty benefits should not be restricted in case of investments through CIVs. On the other hand, the competent authorities agree that an entitlement to the benefits of the Convention that would not have been available in case of a direct investment should be avoided.

Scope of the Agreement

In the case of the Netherlands, the relevant vehicles are FBIs, which are tax liable entities as defined in Article 28 of the Dutch Corporate Income Tax Act (‘Wet op de vennootschapsbelasting 1969’).

In the case of Switzerland, the relevant vehicles are FCPs as defined in Article 25 and SICAVs as defined in Article 36 of the Federal Act on Collective Investment Schemes of 23 June 2006, which are fiscally transparent.
For FBI

Provided that persons who are residents according to Article 4 of the Convention of a Contracting State in which a vehicle mentioned in paragraph 2 is organised (‘Residents’) beneficially own more than 95% of the capital of such a vehicle, that vehicle may claim refund of the withholding tax on income derived from the other Contracting State (‘Source State’) under Articles 10 or 11 of the Convention.

Where the percentage of ownership by such Residents does not exceed 95%, the vehicles mentioned in paragraph 2 may claim refund of the withholding tax under Articles 10 or 11 of the Convention limited to that proportion of the capital of the vehicles beneficially owned by Residents.

For FCP and SICAV

A FCP or SICAV, which is established in Switzerland and which receives items of income to which the Convention applies, may itself, represented by its fund manager or its depository, claim the benefits of the Convention on behalf of the investors which are residents of Switzerland under the Convention.

A FCP or SICAV may not make a refund claim for benefits in respect of an item of income on behalf of any investor in a FCP or SICAV if the investor has itself made a refund claim for benefits in respect of the same item of income.

Administrative procedure

The vehicle or its authorised representatives must indicate, based on data established at the due date of withholding tax in the Source State or at least once every year, and in accordance with the regulations of the Source State, the percentage of ownership of the capital of the vehicle beneficially owned by Residents. For a vehicle mentioned in paragraph 2 with a large number of investors, this may be done through pooled information per country. This vehicle or its authorized representatives may provide the percentage of investors per country in that vehicle on a pooled basis per 1 January of the respective year. Each State may apply appropriate control mechanisms.

The vehicle or its authorized representatives making a claim for treaty benefits under paragraph 3, 4 or 5 using the yearly determination method described in paragraph 7 shall make the determinations described therein to the best of his knowledge and belief. A financial intermediary need not provide investor-specific information to the vehicle or its authorized representatives, or to other financial intermediaries between the owner of beneficial interests and the CIV, at the time the determination is made, but may provide pooled information regarding the owners of beneficial interests. Investor residence may also be determined on the basis of pooled information provided to the financial intermediary by a lower-tier financial intermediary. It is a condition of making a claim pursuant to this competent authority agreement, that the CIV, also regarding pooled information provided by any financial intermediary, must, upon request from the Contracting State in which the income arises, provide to that Contracting State a certification of an accountant. This
certification is to include the confirmation of the pooled information regarding the residence of the owners of the beneficial interest and the reliability regarding the method used to make those determinations.

**Final Provisions**

Paragraph 4 shall not limit the entitlement to treaty benefits of investors in a vehicle mentioned in paragraph 2 who are residents of a third state.

This agreement will replace the Competent Authority Agreement regarding FBIs, FCPs and SICAVs signed in March 2016 and shall apply to all pending and future claims for refunds.

Agreed by the undersigned competent authorities:

Date: 21 March 2018 (Berne)               Date: 12 March 2018 (The Hague)
For the Swiss Competent Authority          For the Netherlands Competent Authority