By Electronic Delivery (to taxpublicconsultation@oecd.org)

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International Co-operation and Tax Administration Division
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development
2, rue André Pascal - 75775 Paris Cedex 16

RE: Application to CIVs of GloBE Proposal – Pillar Two

Dear Members of the Inclusive Framework and the OECD Secretariat,

ICI Global¹ as an association representing the collective investment vehicle (CIV)² industry globally, urges the Inclusive Framework to clarify that the Global Anti-Base Erosion (“GloBE”) proposal does not apply to CIVs. Although we are framing our request as a “carve-out,” we submit that CIVs (as explained below) do not satisfy any of the requirements for the GloBE proposal’s application. Moreover, CIVs do not present the policy concerns underlying Pillar Two.

ICI Global Concerns

Our request is generated by two related concerns. First, although the GloBE proposal appears targeted at related party transactions involving multinational entities (MNEs), elements of the Work Programme suggest broader potential application. Indeed, the “subject to tax” proposal expressly contemplates both (1) applying the rule to interest and royalty payments received from unrelated parties and (2) exploring “risk areas” that might justify broader application.

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¹ ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI’s membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US$30.8 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

² The term “CIV,” as provided in paragraph 22 of the Commentary on Article 1 of the OCED Model Tax Convention on Income and on Capital (November 2017 version), “is limited to funds that are widely-held, hold a diversified portfolio of securities and are subject to investor protection regulation in the country in which they are established.” As noted in the OECD’s 2010 Report entitled “The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles,” in which this CIV definition first was provided, the term CIV “would include ‘master’ and ‘feeder’ funds that are part of ‘funds of funds’ structures where the master fund holds a diversified portfolio of investments on behalf of the feeder funds that are themselves widely held.” 2010 Report, paragraph 4, page 3.
Second, because CIVs typically incur no tax in their jurisdiction of domicile, some might consider CIVs a potential "risk area" that should be explored. The OECD’s 2010 examination of CIV treaty eligibility considerations—as reflected in its Report entitled “The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles” (hereafter the “2010 CIV Report”)—suggests strongly, however, that CIVs are not a “risk area.”

Previous OECD Consideration of CIVs

CIVs, as the OECD has noted, provide small investors with important financial security benefits. Specifically, as noted in paragraphs 8 through 10 of the 2010 Report,3

- “CIVs allow small investors to gain the benefits of economies of scale.”
- “They provide access to . . . markets that might be closed to the small investor.”
- “These benefits are provided in a form that is highly liquid.”
- “CIVs also allow for highly efficient reinvestment of income.”
- “Investors in CIVs benefit from the market experience and insights of professional money managers.”
- “Governments have long recognised the importance of CIVs as a complement to other savings vehicles in terms of facilitating retirement security.”

The 2010 Report also made these relevant tax policy observations that are included in the Commentary on Article 1 of the OCED Model Tax Convention on Income and on Capital (November 2017 version):

- “Although a consistent goal of domestic CIV regimes is to ensure that there is only one level of tax, at either the CIV or the investor level, there are a number of different ways in which States achieve that goal.”4

- “In comparing the taxation of CIVs in the two States, taxation in the source State and at the investor level should be considered, not just the taxation of the CIV itself. The goal is to achieve neutrality between a direct investment and an investment through a CIV in the international context, just as the goal of most domestic provisions addressing the treatment of CIVs is to achieve such neutrality in the wholly domestic context.”5

No tax policy objections have been raised to the conclusions of the 2010 Report. Indeed, the OECD’s Final Report on BEPS Action 6 affirmatively states that there remains “general support” within the Inclusive Framework for the conclusions reached in 2010.6 Not only were the limitation on benefits (LOB) considerations reached in the 2010 Report effectively re-confirmed, but the

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5 Paragraph 33 of the Commentary on Article 1 (November 2017 version). See also paragraph 6.18 of the CIV Report, page 18.

6 BEPS Action 6 Final Report, paragraph 9, on page 15.
BEPS Action 6 Final Report also addressed the application to CIVs of the principal purpose test (PPT) and included a CIV-specific example of cross-border investments not triggering the PPT.7

**Taxation of CIVs and Their Investments**

CIVs receive dividends and interest from their non-controlling investments in the securities of unrelated operating companies. CIV investment strategies also may involve investing in derivatives to hedge against investment risk or as an alternative to investing directly in securities. CIVs also may occasionally invest through “tiered structures.” These structures, including the “master-feeder structures” examined in the 2010 CIV Report, improve CIVs’ abilities to offer units to investors and enhance returns by reducing costs through efficient investing strategies and economies of scale.

The income earned by CIVs generally will be taxed in multiple jurisdictions. As the above-quoted Commentary on Article 1 notes, CIV income may be taxed in the source country, at the investor level, and at the CIV level.

First, source countries impose tax (generally withholding tax) on specified cross-border investments at applicable statutory rates, subject to potential reduction by treaty. Dividend income from cross-border investments traditionally is taxed by all source countries. Interest and gains are less likely to be taxed, but the incidence of source-country taxation of these income streams is growing. The taxes imposed on CIV cross border investments, including potential treaty reductions, apply to portfolio (non-controlling) investments made by all cross-border investors (including CIVs).

Second, CIV investor residence jurisdictions will tax the full investment return (including capital gain) either currently (such as on distributions) and/or when the CIV interests are sold. Tax will be imposed at each individual investor’s applicable tax rate, based upon that investor’s individual circumstances.

Third, tax may be imposed on CIVs by the applicable domicile jurisdiction. In some jurisdictions, tax is imposed directly on the CIV. In other situations, withholding tax is imposed on distributions to CIV investors resident in other jurisdictions.

CIV income from cross-border investments may be taxed multiple times—particularly when CIVs are distributed globally. This potential for over-taxation arises because the tax rules in the respective source, CIV domicile, and investor residence jurisdictions may not be coordinated sufficiently to ensure that foreign tax credits are available to CIV investors.

While it is difficult to generalize regarding the effective tax rate paid on CIV income in all jurisdictions—given the impact of the varying tax rates in investors’ tax residence jurisdictions—one thing is clear. The tax rate imposed on CIV income by the applicable domicile jurisdiction is only one factor—and, generally, the least relevant—in the overall tax paid on that income. Much more relevant in most cases will be the tax withheld by the source country and the tax paid by CIV investors in their residence jurisdictions.

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7 BEPS Action 6 Final Report, example D, on page 60.
CIVs Need Tax Certainty to Calculate Correctly the Value of Each CIV Unit

Investors purchase CIV interests based upon a CIV’s “net asset value” (or NAV). NAV is determined by totaling the value of a CIV’s assets, subtracting its liabilities (including tax liabilities), and dividing the net amount by the number of investment units outstanding.

One of the primary factors for the OECD’s work on CIV treaty eligibility, as reflected in the 2010 Report, was to provide certainty regarding the amount of tax that CIVs would owe on their cross-border investments. Without certainty on tax liabilities, CIV NAVs cannot be calculated with confidence. If NAVs are calculated incorrectly because of tax uncertainty, investors will pay too much or too little for their CIV interests and, likewise, receive too little or too much when they dispose of their interests.

Potential application of the GloBE proposal to CIVs would create substantial uncertainty regarding the amount, if any, of a minimum tax being imposed directly on CIVs.

CIVs and the GloBE Proposal

Given the OECD’s previously-expressed views of CIVs, the GloBE-related question is whether tax policy considerations not already addressed by BEPS would support subjecting CIVs to a minimum level of tax. As CIVs are not operating companies seeking to minimize their tax liabilities—but instead are passive investment pools seeking to maximize financial security for their individual investors—the GloBE proposals would appear inapplicable.

The Income Inclusion Rule

The income inclusion rule would seem to have no application—as it is directed at MNEs with foreign branches or controlled entities. Because CIVs may invest through tiered structures, however, it is possible that tiered structures involving CIVs might be treated as “controlled entities.” Tiered structures, however, have no impact on the total amount of tax effectively paid by CIV investors (in the source country, in the CIV domicile, and in the investor residence jurisdictions). In fact, the tax paid is the same whether CIVs invest directly in the portfolio securities or indirectly through the tiered structure. While we support a narrow definition of controlled entity that effectively excludes CIV tiered structures from controlled entity status, an express carve-out for CIVs would be easier to craft.

The Undertaxed Payments Rule

The undertaxed payments rule, because it applies only to “related party” payments, generally should not be a concern so long as “related party” is not defined too broadly. At most, like with the income inclusion rule, the undertaxed payment rule might have some potential application to tiered structure arrangements. These tiered structure arrangements are not problematic from a Pillar Two policy perspective, however, even if no tax is imposed within the tiered structure. Specifically, as noted above, the income passing through the tiered structure would be taxed at the same rate (in the source country, in CIV investor residence jurisdictions, and in the CIV domicile jurisdiction (if applicable)) regardless of whether CIVs invest directly or through tiered structures. The use of a tiered structure, for investment efficiency reasons, does not reduce the tax paid on CIV investment income. Consequently, the undertaxed payments rule should not apply to CIVs. The express carve-out for CIVs that we request would remove any potential ambiguity.
The Subject to Tax Rule

The subject to tax rule, however, might be a bit more problematic for CIVs—particularly if the total tax paid by CIVs in the source and domicile jurisdictions were determinative. The extent of our concerns with respect to different types of income would turn on the rate at which the GloBE proposal’s minimum tax is set. Dividend payments should not trigger the subject to tax rule even if the taxes paid by CIV investors in their residence jurisdictions are ignored, so long as the minimum tax rate is set at or below the “typical” 15 percent withholding tax rate on cross-border dividend payments. Our more immediate concern with the subject to tax rule arises when a treaty reduces or eliminates tax on interest and/or gains. In this situation, if the rule were applied by looking only to (1) the source-country tax (which might be zero on interest and gains) and (2) the CIV domicile tax (which also might be zero), then the subject to tax rule might disallow the treaty benefit—even though the CIV investors will be taxed on that income. Moreover, had the CIV investors invested directly in the CIVs’ portfolio securities, rather than through CIVs, they would have received the treaty benefit as the GloBE proposal clearly does not apply to individuals.

Applying the subject to tax rule when the “zero-taxed” income will be taxed fully at the investor level—and when sound tax policy supports both the treaty reduction and the domicile exemption—would be thoroughly inconsistent with the GloBE proposal’s objectives. Thus, as with the other components of the GloBE proposal, a carve-out for CIVs should be provided.

Conclusion

CIVs do not appear to present GloBE-related policy concerns. Nevertheless, depending on precisely how the GloBE proposal is crafted, questions might arise regarding the application of Pillar Two to CIVs.

Following on the questions presented in section four of the public consultation document, we urge that all CIVs be expressly carved out of the GloBE proposal. As explained above, there are no facts and circumstances that would support applying the GloBE proposal to CIVs. This carve-out would eliminate compliance costs and provide tax certainty.

Please feel free to contact Keith Lawson (at lawson@ici.org or 1-202-326-5832) or Katie Sunderland (at katie.sunderland@ici.org or 1-202-326-5826) if we can provide you with any additional information.

With kind regards,

/s/ Keith Lawson

Keith Lawson
Deputy General Counsel, Tax Law
ICI Global

/s/ Katie Sunderland

Katie Sunderland
Assistant General Counsel, Tax Law
ICI Global

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8 This same concern would arise for pension funds that receive treaty relief (often exemption) but do not incur tax at the pension fund level. Instead, the investment return is taxed when the plan makes a retirement income distribution to a pensioner. The pension fund situation, therefore, is analogous to that of CIVs.