INVESTMENT COMPANY INSTITUTE

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By Electronic Delivery

July 31, 2009

Barry B. Shott
Deputy Commissioner (International)
Internal Revenue Service
799 9th Street, N.W.
Washington, DC 20024

RE: Portugal Rejecting Treaty Reclaims

Dear Barry:

I would like to bring to your attention information that I just received regarding Portugal's treatment of tax reclaims filed by U.S. mutual funds. This information may be helpful to you and your staff as you continue to discuss with the Portuguese tax authorities their rejections of such reclaims; the ground for rejection, as stated in the attached representative copy of the rejection letters, is that sufficient information has not been provided that "the 'fund' is fully liable to tax in the country of residence and is not fiscally transparent." This proof must be provided "through a declaration issued by the competent authorities of the country of residence within (fifteen days) 15 days, counting from the third day after the registered letter was sent."

The recent information involves advice that a U.S. global custodian received from Portuguese counsel regarding options the bank's fund clients could pursue. According to Portuguese counsel, U.S. taxpayers would need to retain local counsel who then would pursue one of two options. As a practical matter, for the reasons discussed below, under neither option would funds likely receive their treaty benefits.

The first option (a "special administrative action") involves a written appeal to the Portuguese Secretary of State to overturn the decisions in these letters; this appeal would need to be filed within 30 days of receipt of the rejection letter. Portuguese counsel does not believe that this option would be successful (even if the appeal could be filed in time), however, because (to counsel's knowledge) the Secretary of State never has overturned a decision of the tax authorities.

The second option (a "judicial appeal") involves filing suit in the Portuguese courts within 90 days of receipt of the rejection letter; this process likely would involve considerable expense and take at least one year. Moreover, according to counsel, a decision favorable to the funds would not be binding on the tax authorities. Were a fund nevertheless to pursue a judicial appeal, the fund most likely would raise one or both of the following arguments. First, a U.S. fund could argue that the rejection letter is arbitrary and cannot be responded to successfully; the bases for this argument would be that (1) the rejection letter does not specifically define what a fund must do to comply with the Portuguese tax authorities' request and (2) the 15-day period for responding is unreasonable. Second, a U.S, fund could argue that it meets whatever requirements are being set forth by the Portuguese tax authorities. Counsel cautioned, however, that this could be a challenging argument to make because it is not clear what would satisfy the Portuguese tax authorities.

I understand that your staff has explained to the Portuguese tax authorities that the IRS cannot make the requested certifications on Form 6166; I further understand, and appreciate, that your office is working diligently with these authorities to resolve this issue. This advice from Portuguese counsel illustrates the substantial burdens being placed on U.S. funds.

The fund industry would appreciate you sharing this advice from Portuguese counsel with the Portuguese tax authorities and urging the authorities both to retract the rejection letters they have been sending to U.S. funds and to process the funds' reclaims expeditiously. As we have discussed in other contexts, U.S. funds that qualify for regulated investment company ("RIC") treatment clearly meet all treaty eligibility requirements.

Please feel free to contact me if the ICI can provide you with any additional information regarding the Portuguese tax authorities' actions or the factors supporting tax treaty eligibility.

Sincerely,

/s/ Keith Lawson

Keith Lawson
Senior Counsel – Tax Law

Attachment

cc: David Marion
Aziz Benbrahim

finanças
DIRECÇÃO GERAL DOS IMPOSTOS

DIRECÇÃO DE SERVIÇOS DAS RELAÇÕES INTERNACIONAIS

Ofício n.º: **14948** **2009-06-29**
Processo: 16/2009
Entrada Geral:
N.º Identificação Fiscal (NIF) [redacted]
Sua Ref.ª:
Técnico: CR
Cod. Assunto:
Origem:

TO:
[redacted]
USA

Registado

SUBJECT: CLAIM FOR REFUND OF PORTUGUESE TAX UNDER THE CONVENTION FOR THE AVOIDANCE OF DOUBLE TAXATION BETWEEN PORTUGAL AND **EUA**

TIN OF THE ISSUER	*ISIN CODE*	*PAYABLE DATE*	*NUMBER OF SHARES*	*GROSS DIVIDENDS*
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Concerning the above mentioned request of tax refund, and according to the terms of the Article 60, section b), paragraph 1, of the Portuguese General Law, you are notified that we intend to reject that request with the following grounds:

Given the nature of the requesting entity "fund", there is any information that this fund meets the following requirement:

The "Fund" is fully liable to tax in the country of residence and is not fiscally transparent (in other words, the fund is not liable to tax separately from its subscribers).

So, we further notify that you can take the following actions regarding this decision:

- You have the right to reply in written. Prove shall be made, namely through a declaration issued by the competent authorities of the country of residence within (fifteen days) 15 days, counting from the third day after the registered letter was sent. You can include all missing prove elements, in order for us to review the proposed decision.
- The elements of prove you may add, should be send to Direcção de Serviços das Relações Internacionais, Av. Eng. Duarte Pacheco, nº 28- 4º Andar, 1099-013 Lisboa, mentioning this letter.

Sincerely yours,

The Head of Division

António Videira

AV. ENGENHEIRO DUARTE PACHECO, N.º 28 - 4º ANDAR - 1099 - 013 LISBOA
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By Electronic Delivery

April 1, 2009

Ms. Judith Herdin-Winter
Deputy Head of Division
International Tax Law, Division IV/4
Federal Ministry of Finance
Vienna, Austria

RE: Treaty Eligibility for RICs under Austria-U.S. Tax Convention

Dear Judith:

The Investment Company Institute ("ICI"),[1] on behalf of the shareholders in those regulated investment companies ("RICs") investing in Austria, urges the Ministry to clarify that RICs are eligible for reduced withholding tax rates under the Austria-U.S. income tax convention. We are making this request because we have been informed that the Ministry views non-Austrian collective investment vehicles ("CIVs") as "tax transparent" and therefore not eligible to claim treaty benefits in their own right.

Austrian officials responsible for paying tax reclaims, we have been told, are informing non-Austrian CIVs, including RICs, that an "attestation of holdings" must be filed for all reclaims filed after December 31, 2007 and not yet paid. This attestation, we understand, requires a CIV to report: (1) the "percentage of units held by investors entitled to the benefits of a Double Tax Treaty with Austria at closing date of the last accounting period"; (2) the "closing date of the accounting period"; and (3) the identity of any investor "holding at least 10% in the Investment Vehicle (Certificate of Residence in original has to be enclosed)."

We also have heard that, following discussions between the Ministry and the United Kingdom's Inland Revenue, the Ministry determined that U. K. CIVs were not required to complete the attestation because U. K. CIVs were entitled to treaty benefits in their own right. I met this

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $9.47 trillion and serve over 93 million shareholders.

morning with Barry Shott, the U.S. Competent Authority, and his colleagues to request that they also discuss this issue with the Ministry.

I am writing to ensure that the Ministry understands correctly how RICs are organized and operated, as well as how they are taxed, in the United States. After describing the organization, operation, and taxation of RICs, this letter explains why the ICI believes that RICs are entitled to benefits under the Austria-U.S. convention and need not complete the attestation.

The Organization and Operation of RICs

RICs are investment vehicles that pool customer assets and provide asset diversification, professional management, and investor services at reasonable cost. The typical RIC investor does not have sufficient assets to make cost-effective direct investments in securities of U.S. issuers; it would be even more difficult for the typical RIC investor to invest directly in non-U.S. securities.

RICs may be organized as retail investment vehicles, as institutional investment vehicles, or as combined retail/institutional vehicles (with separate classes of shares for the retail and institutional investors). RICs typically have thousands of shareholders; some RICs have hundreds of thousands of shareholders.

The most common type of RIC is the mutual fund.[2] Because mutual funds issue redeemable securities, they also are known as open-end investment companies.[3] Mutual funds typically offer their shares continuously through a public offering. The number of shareholders in a mutual fund varies constantly (typically on a daily basis).

The Taxation of RICs and Their Investors

U.S. (Subchapter M)Taxation of RICs

RICs are corporations for U.S. federal income tax purposes. As such, they are taxed just like operating companies organized in corporate form, unless they qualify for the tax treatment provided by Subchapter M of the U.S. Internal Revenue Code. Subchapter M treatment is very different than the tax treatment provided by U.S. law for partnerships and other pass-through vehicles. Among other things, unlike partnerships, neither net operating losses nor net capital losses realized by the

[2] Mutual funds have a fluctuating number of shares outstanding. Most mutual funds continuously offer their shares to the public; all mutual funds are required to redeem their shares at any time for the shares' net asset value ("NAV"), which is determined by dividing the fund's net assets by the number of shares outstanding.

[3] The other types of RICs are exchange-traded funds ("ETFs"), closed-end funds, and unit investment trusts ("UITs"). The primary differences between these RICs involve the manner in which investor interests (*e.g.,* shares) are purchased or sold. If additional information regarding these RICs would be helpful, we would be pleased to provide it.

RIC flow through to the RIC's shareholders; while net capital losses are carried forward to the RIC's next taxable year, net operating losses do not carry forward (but expire and are lost).

A U.S. investment company cannot qualify for Subchapter M taxation as a RIC (under Code sections 851 and 852) unless it meets several tests. These tests include those regarding the sources of its income, the diversification of its assets, and the distribution of its income.

One notable requirement involves RIC distributions. Under Subchapter M, a RIC must distribute with respect to its taxable year at least 90 percent of its income (other than net capital gain). Importantly, the remaining 10 percent of ordinary income, and all capital gain, may be retained. Moreover, all retained income is taxed at regular corporate tax rates.

Because a RIC that incurs corporate tax provides a lower return than one that does not incur such tax, RICs generally attempt to distribute all of their income. In addition, because RICs are taxable under an excise tax unless they distribute essentially all of their income in the calendar year in which it is earned,[4] RICs typically distribute their income currently. Nevertheless, RICs may retain substantial amounts of their income and still qualify for Subchapter M treatment.

U.S. Taxation of U.S. Investors in RICs

RIC investors are not taxed as if they own the RIC's underlying assets directly. Specifically, RIC investors are not taxable on the RIC's income as it is earned by the RIC and generally are not taxable on amounts that are not distributed.

Instead, RIC investors are taxed only upon: (1) the receipt of RIC distributions (whether received in cash or reinvested in additional RIC shares); and (2) the disposition of RIC shares. Importantly, a RIC shareholder is taxed on a distribution whether or not the shareholder was invested in the RIC on the date that the income was received by the RIC.

All RIC distributions are taxed as ordinary dividends (because RICs are corporations for U.S. income tax purposes), unless the tax law expressly permits the character of the income to be retained. Thus, the tax character of the income received by the RIC only flows through to the RIC shareholders if legislation provides special flow-through treatment. Among other things, RICs cannot flow through the character of "short-term" gains (on assets held for one year or less) to their U.S. shareholders; instead, these amounts are taxed as ordinary dividends upon distribution. Because

[4] Specifically, U.S. tax law imposes an excise tax (under Code section 4982) on any RIC that does not distribute essentially all of its income during the calendar year in which it is earned. To eliminate any excise tax liability, a RIC must distribute by December 31 an amount equal to the sum of: (1) 98 percent of its ordinary income earned during the calendar year; (2) 98 percent of its net capital gain earned during the 12-month period ending on October 31 of the calendar year; and (3) 100 percent of any previously-earned amounts not distributed during the prior calendar year. A tax of 4 percent is imposed on the amount, if any, by which the RIC's required distribution exceeds the amount actually distributed. The excise tax, in effect, acts as an interest charge on undistributed amounts.

short-term gains are taxed as ordinary income, a RIC shareholder cannot offset these amounts by capital losses incurred on other assets.

Thus, RIC shareholders are taxed very differently from investors in pass-through vehicles like partnerships.

Reasons that RICs are Owned Almost Exclusively by U.S. Investors

RICs are owned almost exclusively by U.S. investors who are entitled to claim treaty benefits if they invest directly in Austrian securities. One of the many reasons that RICs are attractive investment vehicles for U.S. investors seeking exposure to Austrian securities is that the treaty entitlement of any individual investor is likely to be too small for that investor to pursue an individual claim for treaty benefits.

There are two reasons why RICs are owned almost exclusively by U.S. investors. First, the U.S. rules for taxing passive foreign investment companies ("PFICs"), which include all non-U.S. investment companies, create significant tax disincentives to U.S. investors who acquire PFIC shares.

Second, the U.S. tax treatment of non-U.S. investors in RICs in three important ways reduces significantly the attractiveness of RICs to non-U.S. investors. These three adverse tax effects are: (1) U.S. taxation of non-U.S. source income;[5] (2) current distributions of income and gain;[6] and (3) resident-country taxation at "regular" rates of RIC capital gain distributions, where capital gains receive favorable treatment in the investor's residence country.[7] Each of these tax effects[8] results in a

[5] Non-U.S. investors in RICs are taxed in the United States on income that RICs earn from investments outside the United States. Because a RIC's distributions are treated as U.S.-source dividends, they are subject to U.S. withholding tax (at 30 percent or a lower treaty rate). Any non-U.S. investor investing in the same non-U.S. securities directly or through a non-U.S. collective investment vehicle ("CIV") would not incur any U.S. tax. Thus, the income may be taxed in three countries (the source country, the United States, and the residence country) when the investment is made through a RIC, whereas the income would be taxed only twice (or perhaps once) if the investment is made directly or through a non-U.S. CIV. While a non-U.S. investor may be able to claim a foreign tax credit for the U.S. withholding tax, such a credit in all likelihood would not be available for the tax withheld by the source country on the payment to the RIC.

[6] Non-U.S. investors in RICs in all likelihood will be taxed currently in their country of residence on the RICs' annual distributions. Residence country taxation occurs irrespective of whether that country otherwise permits deferral of tax on investments in CIVs that do not distribute their income.

[7] RIC capital gain dividends, as we understand non-U.S. law, are treated in non-U.S. countries as "regular" dividends; the preferential "capital gains" nature of the distribution is not retained for non-U.S. tax purposes. Thus, RIC distributions of capital gains typically will not qualify for any tax preference provided in a residence country for capital gains.

[8] One last relevant feature of U.S. tax law involves information reporting on amounts paid to non-U.S. investors. U.S. payors (including brokers, banks, and funds) must report such payments to investors (on IRS Form 1042-S) and to the IRS (on IRS Form 1042). This tax information is available to resident-country governments under exchange of information provisions in U.S. tax treaties.

RIC's non-U.S. investors being disadvantaged vis-à-vis direct investors or investors in non-U.S. collective investment vehicles ("CIVs").

For these reasons, RIC shares typically are registered for sale in all 50 states in the U.S., but almost never for sale outside of the United States.

Satisfaction of Treaty Requirements

The ICI submits that RICs satisfy each requirement (person, resident liable to tax, and beneficial owner) for treaty benefits. As the Ministry appears to be concerned with tax transparency, this letter focuses first on that issue.

RICs are Not Transparent

While the value of a RIC's shares includes the value of any income (such as dividends, interest, or capital gain) earned by the RIC, a shareholder has no right to receipt of that income until a dividend with respect to that income is declared. If an investor sells shares before the dividend is declared, the investor is not entitled to the dividend. Conversely, if the investor buys shares after the income is earned but before the dividend is declared, the investor is entitled to the dividend. Moreover, because of anti-preference provisions included in U.S. tax law (the so-called "preferential dividend" rules of Code section 562(c)), items of income or tax benefit cannot be specially allocated to individual shareholders.

RICs Are Not Treaty-Shopping or Tax-Avoidance Vehicles

Additional support for the treaty-eligibility of U.S. RICs comes from those provisions of U.S. tax law that protect the interests of the source and residence countries.

The interests of source countries are protected by the provisions of U.S. tax law (including U.S. withholding tax on distributions by RICs of non-U.S. source income) that severely limit the use of a RIC for treaty shopping purposes. For example, assume the worst case scenario – in which the U.S. has treaties with both the source country ("Country A") and the residence country ("Country C"), but no treaty exists between Countries A and C. In this case, a $100 dividend paid by a Country A company to a Country C investor would be taxed at a 30% rate; the net distribution (pre-residence country tax) would be $70. If instead, the investment were made through a RIC, the net distribution (pre-residence country tax and before fund expenses) would be $72.25 ($15 withholding by Country A at 15% rate on the $100 dividend and $12.75 withholding by the U.S. at 15% rate on the net $85 dividend). Any potential, and presumably quite modest, benefit most likely would be more than offset by (1) the RIC's expenses and (2) the loss of any residence-country foreign tax credit for the taxes paid by the RIC to the source country.

The interests of the residence country are protected by the provisions of U.S. tax law that require information reporting to the investor and the IRS of amounts paid to non-U.S. investors. The residence country tax authorities can access this information through exchange of information provisions.

* * *

The ICI urges, for the reasons above, that the requested clarification be issued promptly. If the ICI can provide you with additional information regarding the taxation of RICs and why we believe they are entitled to the benefits of the convention, please do not hesitate to contact me at 001-202-326-5832 or lawson@ici.org. I will call you soon to discuss this matter further.

Sincerely,

/s/ Keith Lawson

Keith Lawson
Senior Counsel – Tax Law

cc: Barry Shott

ATTESTATION OF HOLDING

For tax reclaims on dividends derived from Austrian equities received by Non-Austrian Investment Vehicles.

Managing Company

Name of Investment Vehicle or Investment Company:

……………………………………………………………………………………………..

Registered office of the Investment Vehicle or Investment Company:

……………………………………………………………………………………………..

Name, capacity, and address of the signatory:

……………………………………………………………………………………………..

Percentage of units held by investors entitled to the benefits of a Double Tax Treaty with Austria at closing date of the last accounting period:

……………………………………………………………………………………………..

Closing date of the accounting period: ……………………………………………………

Disclosure of Investors holding at least 10 % in the Investment Vehicle (Certificate of Residence in original has to be enclosed).

……………………………………………………………………………………………..

……………………………………………………………………………………………..

Attachments: ………*Certificates of Residence*

The undersigned declares that the information provided in this attestation is correct.

Place and date: ……………………………………………………

Stamp and authorised signature: …………………………………………………….