THE ASSOCIATION OF GLOBAL CUSTODIANS

BNY MELLON
BROWN BROTHERS HARRIMAN
CITIBANK, N.A.
DEUTSCHE BANK
HSBC SECURITIES SERVICES
J.P. MORGAN
NORTHERN TRUST
RBC INVESTOR & TREASURY SERVICES
SKANDINAVISKA ENSKILDA BANKEN
STANDARD CHARTERED BANK
STATE STREET BANK AND TRUST COMPANY

COUNSEL AND SECRETARIAT TO THE ASSOCIATION:
BAKER & MCKENZIE LLP

EUROPE
ATT: ARUN SRIVASTAVA
100 NEW BRIDGE STREET
LONDON EC4V 6JA, ENGLAND
INT'L TEL: 44 20 7919 1000

GLOBAL
ATT: ROBIN TRUESDALE
815 CONNECTICUT AVENUE, N.W.
WASHINGTON, D.C. 20006
TEL: 202 452 7000
FAX: 202 452 7074

WWW.THEAGC.COM

9 January 2015

VIA E-MAIL

Ms. Marlies de Ruiter
Head, Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy & Administration
Organisation for Economic Co-operation and Development
2, rue André-Pascal
75016 Paris
France
taxtreaties@oecd.org

Re: Comments on Discussion Draft on BEPS Action 6: Preventing Treaty Abuse

Dear Ms. de Ruiter:

This letter is submitted on behalf of the members of the Association of Global Custodians ("AGC" or "Association") to provide you with comments in respect of the OECD Discussion Draft: Preventing Treaty Abuse, issued on 21 November 2014 (the "Discussion Draft") pursuant to Action 6 of the BEPS Action Plan.

As you know AGC members have been keenly following (and in some cases actively participating in) the work of the Organisation for Economic Co-Operation and Development ("OECD") for many years on various key tax developments and welcome the opportunity to provide comments to you on the second Discussion Draft.

The Association is an informal group of 11 member banks that provide securities safekeeping and asset serving functions to cross-border institutional investors worldwide including investment funds, pension funds, and insurance companies.

In providing global custody services, AGC members routinely seek appropriate tax treaty withholding tax relief on behalf of custody clients. The members typically collectively process millions of such relief claims each year, affecting substantial amounts of cross-border portfolio investment flows in and out of countries worldwide. A significant portion of the income for which the members process treaty relief claims is income received by institutional investors. As such, the AGC members experience on a daily basis the costs, inefficiencies, and excessive withholding that arises when the procedures for claiming lawful relief are unduly burdensome or complicated for the investors involved, or when the

standards for entitlement to treaty relief are too unclear or complicated to effectively accommodate treaty relief claims, whether at source or by refund.

For these reasons, the AGC wishes to share with the OECD certain observations relating to the Action 6 proposals for introducing anti-abuse provisions into treaties. The attached Annex sets forth the Association's general comments on the proposals as well as more specific comments in response to the various issues raised in the Discussion Draft. These comments are primarily focused on the operational implications of the proposals for the process of obtaining legitimate treaty relief on high volume portfolio income flows. The AGC would be pleased to provide follow-up information on any of the points raised if desired by the OECD.

Sincerely yours on behalf of the Association,

Mary C. Bennett
Baker & McKenzie LLP
Counsel to the Association

Annex

ANNEX

AGC Comments on the 21 November 2014 Discussion Draft on BEPS Action 6 (Preventing Treaty Abuse)
9 January 2015

The Association of Global Custodians ("AGC") is an informal group of 11 member banks that provide securities safekeeping and asset serving functions to cross-border institutional investors worldwide including investment funds, pension funds, and insurance companies.

In providing global custody services, we routinely seek appropriate tax treaty withholding tax relief on behalf of custody clients. The members typically collectively process millions of such relief claims each year, affecting substantial amounts of cross-border portfolio investment flows in and out of countries worldwide. A significant portion of the income for which our members process treaty relief claims is income received by institutional investors. As such, we experience on a daily basis the costs, inefficiencies, and excessive withholding that arises when the procedures for claiming lawful relief are unduly burdensome or complicated for the investors involved, or when the standards for entitlement to treaty relief are too unclear or complicated to effectively accommodate treaty relief claims, whether at source or by refund.

Based upon our perspective as custodians responsible for processing a high volume of treaty claims on behalf of our primarily institutional investor clients, we set forth below some general comments on the introduction of treaty anti-abuse provisions contemplated by the BEPS Action 6 Discussion Draft released on 21 November 2014 (the Discussion Draft), as well as specific views on certain of the individual issues on which the Discussion Draft seeks comments.

General Comments on Discussion Draft

As previously underlined in our comments submitted on 9 April 2014, due to the nature of the industry we operate in, members of the AGC have a direct interest in the lawful and warranted application of tax treaty benefits for our clients worldwide. While we fully understand and support the need to prevent abusive practices and the unintended use of double tax treaties, we are nevertheless concerned about the potential undesirable effects certain proposals put forward under Action 6 might have on governments and institutional investors alike.

We are particularly concerned that the introduction of specific measures such as the recommended Limitation on Benefits ("LOB") provision and the principal purpose test ("PPT") will result in disproportionate outcomes, investor uncertainty, and a shift from the current trend of granting treaty benefits at source to the more burdensome, non standard, costly reclaim method of relief.

PPT

A tightening in treaty relief procedures through the introduction of a PPT will likely result in the widespread use of the reclaim mechanism. Combined with the uncertainties associated with broadly-defined avoidance provisions, these measures represent a backward step in the OECD's prior work in the area of treaty entitlement for collective investment vehicles ("CIVs") and the Treaty Relief and Compliance Enhancement ("TRACE") project. With the

backdrop of the introduction of automatic exchange of information initiatives, including US FATCA and the Common Reporting Standard (CRS), a reclaim procedure appears unnecessary when a tax authority will have sufficient information available, in particular, for an ordinary commercial transaction that CIVs and non-CIV funds undertake.

The PPT implies more onerous documentation requirements and the need for a greater level of resources (in many cases including external tax counsel), implying an increase in not only the associated operational costs but also in the opportunity costs suffered by investors that cannot immediately obtain due entitlements.

Where the costs incurred in collating, certifying, and submitting the data required outweigh the related treaty benefits, investors are likely to choose not to engage in an onerous treaty relief procedure and may therefore waive their legitimate rights to treaty benefits.

Such an outcome would be particularly detrimental for institutional investors because withholding taxes suffered abroad generally cannot be credited against tax liabilities in the state of residence (for example in the case of tax exempt entities such as pension funds and sovereign wealth funds), and the withholding taxes levied therefore represent a final cost. The outcome may also be detrimental for certain residence countries where institutional investors can credit/deduct their foreign withholding taxes against their domestic tax liabilities. Indeed, if there is a significant increase in foreign withholding tax expenses for the residence country this may severely impact their tax revenue, particularly if they cannot offset the increase through their own PPT/ LOB provision.

The outcome of this could lead to:

- the residence country's tax authorities being called on to intervene where taxpayers are not receiving their due treaty relief;
- changes in domestic policy to overcome revenue gaps caused by the denial of treaty relief; and
- use of the PPT as a means to compensate for tax revenue lost to source states.

Whilst individually foregone treaty benefits may not always be significant, in the aggregate these will have a substantial negative impact on investment markets. Such a result conflicts with the purpose of double tax treaties and is surely not desirable where the majority of investors are engaged in genuine investment activities and as such have a valid claim to treaty benefits.

<u>LOB</u>

The introduction of an LOB provision into treaties is somewhat counterintuitive in light of the general trend in past years towards encouraging institutional investors to expand their operations cross-border (e.g. efforts within the European Union to implement a cross-border registration process for UCITS funds and similar schemes that are being considered across Asian markets).

Indeed, an LOB provision may act as a disincentive for funds to widely distribute, unless, a workable "equivalent beneficiary" and "derivative benefits" provision is introduced, which would not entail an onerous compliance burden on the fund.

We would therefore strongly urge the introduction of a waiver from any LOB, PPT or other anti-abuse provisions for institutional investors where the risk of treaty abuse is low, such as widely-held CIVs, life insurance companies, regulated pension funds, and sovereign wealth funds. Without such a waiver and in the event of the introduction of an LOB and/or PPT through a multi-lateral agreement (Action 15), treaty access for such institutional investors could be thrown into uncertainty on a global basis causing widespread disruption to the effectiveness of such investors in the context of cross-border investment. We furthermore keenly support the introduction of the TRACE Implementation Package (IP) and encourage the OECD to consider how the TRACE IP in coordination with US FATCA and the CRS can be used to overcome treaty abuse concerns before introducing anti-avoidance measures. We also urge the OECD to opt for a coordinated and focused approach to anti-abuse provisions that leaves little room for interpretation and therefore ensures a consistent application across jurisdictions and the smooth functioning of international tax treaty networks.

Specific Comments on Discussion Draft

Issue #1 -- Collective investment vehicles: application of the LOB and treaty entitlement

We commend the OECD for the work it did in producing the 2010 CIV Report. It properly took into account the fact that CIVs take a variety of different forms and have different investor populations. It therefore provided different approaches to determining the substantive and procedural bases on which treaty benefits could be provided to CIVs, each tailored to the particular attributes of different types of CIVs. Therefore, while we understand the temptation to want to have a single preferred approach, we believe the OECD was right in 2010 in acknowledging that there was no "one size fits all" approach and we recommend retaining the flexibility to apply different approaches to different cases.

We further commend the OECD for the work done in the TRACE project, particularly in developing the TRACE Implementation Package. The CIV and TRACE work was a serious effort to analyze the real practicalities of applying LOB-like criteria to the high volume, heavily intermediated reality of cross-border portfolio investment by widely held, regulated investment funds. The solutions ultimately reflected a careful weighing and balancing of multiple interests: source State interests in ensuring treaty relief was available only to properly identified residents of treaty partners, residence State interests in ensuring that bargained for source State treaty relief was granted without the need for costly residence State involvement in documentation requirements or for excessive foreign tax credit claims, and investor interests in obtaining legitimate treaty relief at the withholding stage through the application of certain, non-overly burdensome procedural requirements.

Our experience as custodians has shown us how critical it is for consideration to be given to the practicalities of applying particular substantive requirements that may derive from the application of anti-treaty shopping principles to CIVs. The CIV Report and TRACE Implementation Package take into account the need to provide clear and administrable procedural approaches to establishing entitlement to benefits where that entitlement

depends upon the status of the investors in the CIV. They recognized the prohibitive cost of CIV documentation requirements that are excessively demanding in light of the risk of abuse, the extent of intermediation in investment channels, and the high numbers of investors involved. They acknowledged the need for substantive rules (including derivative benefits provisions) that adequately take into account the non-abusive, multinational character of many CIVs and also the needs for streamlined, harmonized procedural approaches for claiming benefits.

Regrettably, countries for the most part have not moved to adopt the CIV Report and TRACE IP recommendations, and the procedures for claiming treaty benefits have become much more burdensome in recent years, particularly as some countries have sought to impose incredibly onerous documentation requirements to prove CIVs' satisfaction of LOB-like standards. This has led to widespread inability to obtain treaty relief legitimately due, with excessive withholdings now totaling in the billions of dollars.

We therefore urge the OECD not to abandon the approaches laid out in the CIV Report, and we encourage both OECD and non-OECD member countries, as a matter of urgency, to move forward as soon as possible with actual implementation of the recommendations of the CIV Report and TRACE Implementation Package.

Issue #2 -- Non-CIV funds: application of the LOB and treaty entitlement

The Discussion Draft notes that sovereign wealth funds, pension funds, and alternative funds / private equity funds are not covered by the CIV Report and have expressed concerns about the potential effects on them of introduction of LOB requirements. We share those concerns. In particular, we have begun to see widespread denial of access to treaty benefits for pension funds as some countries have started to impose requirements demanding extensive documentation with respect to every underlying participant in the fund. The practical inability of pension funds to meet these kinds of procedural documentation demands, notwithstanding the fact that the funds' satisfaction of the substantive treaty requirements is typically a virtual certainty, is operating in a great many cases to make legitimate treaty relief unattainable or prohibitively expensive. It is therefore very wrong to assume that reasonable-sounding LOB standards pose no threat to treaty entitlement in most cases without taking into account the practical manner in which satisfaction of those standards will be established. It is interesting to note that for purposes of FATCA and the CRS, broad exemptions have been provided to pension funds (and other entities included in Annex II of a FATCA Intergovernmental Agreement), thereby relieving them of onerous documentation and reporting requirements with respect to their participants, and those precedents may be useful to analyze in this context.

We urge the OECD as a matter of priority to study the situation of non-CIV funds, especially pension funds (including pension funds pooling their investments through regulated tax transparent funds), in much the same way as it studied CIVs, working jointly with the fund industry, in order to get a better understanding of the limited extent of the treaty shopping risk these funds pose and of the feasibility of particular practical approaches for a fund to establish its entitlement to claim benefits. Thought should be given to the types of information that could help to demonstrate the likelihood that pension funds are primarily benefitting individuals from treaty partner jurisdictions, so that little to no treaty shopping

risk exists, without demanding exhaustive documentation from each individual participant. Factors such as the tax disadvantages of individuals' participation in foreign pension plans and the primary operating locations of employers sponsoring the plans should help to assure governments that pension funds established in a treaty partner are primarily benefitting the right group of individuals, without the need for extensive documentation.[1] We would also mention that when the CRS analysis was undertaken it was recognized that the tracing of underlying investors in pension funds was unwarranted, and that it is widely acknowledged that pension funds are not considered flow through entities and are the beneficial owners of income in their own right.

We fully support the treaty policy that provides a mutual exemption for the investment income of specified types of qualifying pension funds in each Contracting State, and we recommend, again as a matter of urgency, that the OECD work with governments and the pension fund industry to determine the types of criteria and also the procedural approaches that should be used for determining qualification for that treatment.

Issue #6 -- Issues related to the derivative benefit provision

The CIV Report properly acknowledged the derivative benefits concept as one that was potentially relevant to determining CIVs' entitlement to treaty relief. We believe the same concept should be considered relevant for other collective funds as well, including pension funds. In other words, the existence of third country participants in a treaty country pension fund should not serve to endanger the fund's entitlement to treaty benefits where the third country individuals are resident in treaty partners of the source State and are entitled to benefits comparable to those provided to individuals resident in the treaty country.

Issue #8 -- Timing issues related to the various provisions of the LOB rule

We understand the objective of ensuring that entities claiming treaty benefits are entitled to the benefits as of the time they are being claimed. In the context, however, of high volume portfolio investment flows where treaty relief is effectively administered by withholding agents at the time of payment, some accommodation needs to be considered for purposes of practicality to base the claims on information available as of a prior date. For example, paragraph 6.31 of the Commentary on Article 1, which grew out of the CIV Report, recommends that CIVs be entitled to claim benefits based on information allowing them to make determinations annually (or not more frequently than quarterly) of the status of their investors as of a date preceding the period for which benefits are to be claimed.[2] Similar approaches should be considered for other types of collective investment funds.

---

[1] See paragraph 6.30 of the Commentary on Article 1 of the OECD Model Convention, which referenced comparable assumptions for CIVs as a result of the CIV Report.

[2] The proposed Memoranda of Understanding relating to CIV claims included in the TRACE Implementation Package give an example of this approach: "For example, a determination made on December 31, 2008, would be based on the equivalent beneficiary ownership percentages from November 1, 2008 and would apply with respect to the whole of 2009."

Issue #12 -- Inclusion in the Commentary of the suggestion that countries consider establishing some form of administrative process ensuring that the PPT is only applied after approval at a senior level

As indicated in our general comments above, we are concerned that widespread introduction of PPT provisions into treaties could lead to a proliferation of non-harmonized procedural and documentation requirements which could serve to exacerbate the already serious difficulties being faced by CIVs, pension funds, and other institutional investors in obtaining the treaty relief to which they are legitimately entitled. In the case of the PPT, that concern is potentially more serious than under the LOB provision, because neither the funds nor, importantly, their withholding agents can be certain of the precise criteria source States will view as relevant to the application of the PPT without detailed guidance on that point from the source States themselves.

The proposed Commentary on the PPT gives an example of a CIV that qualifies for benefits under the PPT based on a number of factors included in the example, but a CIV (or its withholding agent) could legitimately wonder whether the conclusion would be different if the facts were different (e.g., if the CIV was not majority-owned by residents of its own country) or if there were procedural difficulties that precluded the CIV from proving the existence of the facts.

For this reason, we think it will be extremely important to the smooth operation of treaty claims in a world of widespread PPT provisions for the countries having such provisions in their treaties to offer some procedural mechanisms to provide certainty to all cross-border portfolio investors and withholding agents about whether the income of the investors will enjoy the reduced rates outlined in the treaty. An absolute minimum for providing such certainty would be the kind of high level panel mentioned in the Discussion Draft. A timely ruling process should also be part of the minimum standard of procedural safeguard to be associated with a PPT provision.

Issue #15 -- Whether some form of discretionary relief should be provided under the PPT rule

We support the suggestion in the Discussion Draft that “fallback” treaty relief should be available when the PPT rule is applied to deny treaty benefits on a theory that the substance of a transaction should be treated as different from its form, where the recharacterized transaction would itself be eligible for treaty relief.

Issue #17 -- List of examples in the Commentary on the PPT rule

As indicated above, we have some concern that the investment fund example in the proposed PPT Commentary may not provide adequate guidance to collective fund structures that present different facts. While we will leave it to the fund industry to provide its own suggested example(s) of qualifying situations under the PPT, we would emphasize the importance of accommodating cases where funds have investors from multiple countries (albeit without posing significant treaty shopping concerns) and of scoping out reasonable procedural approaches for claiming benefits in such cases.