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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
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France
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Re: Comments on Discussion Draft on Treaty Residence of Pension Funds

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: Treaty Residence of Pension Funds, issued on 29 February 2016 (the "Discussion Draft") as part of the follow-up work on 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 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, including pension funds. 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.

Our comments are attached in the Annex.

Sincerely yours on behalf of the Association,

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

Annex
Appendix 1
Appendix 2

ANNEX

AGC comments on the 29 February 2016 Discussion Draft on the Treaty Residence of Pension Funds

The Association welcomes the effort to ensure that "recognised pension funds" will be guaranteed treatment as residents of the State where they are established for tax treaty purposes. Our comments are therefore primarily focused on the definition of "recognised pension funds". We address below the four specific questions ("a" through "d") posed by the Discussion Draft, after which we provide some additional comments.

> a) ***As regards the phrase "that is treated as a separate person under the taxation laws of that State" included in the definition of "recognised pension fund" in proposed Art. 3(1)j):*** Does that phrase deal adequately with pension funds established in your State? If not, what other formulation would ensure that pension funds, the income of which is not otherwise attributed to another person for tax purposes, are treated as residents?

The condition of being a separate person for tax purposes could result in the exclusion of certain contractual trust or similar arrangements that are not treated as separate persons for tax purposes in their home country but are effectively granted special treatment there as pension vehicles. An example of this problem can be found in relation to contractual trust arrangements that are set up by employers under German law to fund pension benefits to employees. Under German tax law, the assets of such funds are treated as belonging to the employer, but the employer can reduce its taxable profits by the incremental pension obligation to the employee, based on an actuarial computation, and the employee is not taxed until there is a distribution. In order to address the fact that such a segregated fund is not a separately identifiable "person" for German tax purposes, the 2006 Protocol to the U.S.-German Tax Treaty included language to clarify that such arrangements would be treated as pension funds that are residents of Germany, thereby making them eligible for the exemption on U.S. dividend withholding tax provided under Article 10(3)(b) of that Treaty, and this position was further clarified by a 2012 Competent Authority Agreement between the United States and Germany.[1]

This example shows that requiring an arrangement to constitute a "separate person" under the taxation laws of the State where the arrangement is established in order to qualify as a "recognised pension fund" may lead to inappropriate results if the intention is to ensure that income derived by pension vehicles will be treated as the income of a "resident" of the State where the vehicle is established (and as potentially eligible for specific treaty exemptions provided to "pension funds" of that State). The approaches used by different States to accord "pension fund" status to vehicles established in those States differ enough that a blanket requirement that an arrangement constitute a "separate person" for tax purposes will likely inappropriately exclude certain pension fund arrangements.

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[1] A copy of the 2012 Competent Authority Agreement between the United States and Germany is attached as Appendix 1, and a copy of the following article, which provides further background on this arrangement, is attached as Appendix 2: Portner, "Challenges in Characterizing a German Contractual Arrangement", *Worldwide Tax Daily* (2013 WTD 111-18). The Portner article notes that a contractual trust arrangement (CTA) may be set up in Germany for the employees of a German branch of a foreign employer, which underlines the significance of effectively treating the CTA as a resident of Germany even though its assets are treated for German tax purposes as belonging to the employer.

Another example relates to pension schemes arranged through insurance companies. These arrangements are quite common in the United Kingdom and are known there as unit-linked pension funds, i.e. a separate, identifiable, pool of assets that represent the pension business of an insurance company. The fund is registered with HMRC and treated as a pension fund for tax purposes. It is not however a separate entity and it is therefore questionable if it can be said to be a separate tax person. Where treaty partners wish to characterize such funds as pension funds eligible for treaty benefits, they typically do so by defining eligible funds in a way that eliminates any requirement that they be treated as a separate person for tax purposes[2] or by including a specific reference to such funds in their definition.[3]

Suggestion: The Association therefore suggests that the OECD eliminate the requirement that an entity or arrangement be a "separate person" for tax purposes in the State where it is established. Treaties that have omitted such a requirement in their description of pension funds that will qualify as "residents" have avoided the kinds of problems which the special U.S.-German Protocol and Competent Authority Agreement were needed to solve.[4]

Suggestion: If for any reason delegates decide not to eliminate this requirement from the definition of "recognised pension fund" as a general matter, the Association recommends that the OECD Model specifically accommodate a bilateral agreement designating pension entities or arrangements that do not constitute separate persons for tax purposes as "recognised pension funds".[5]

b) ***As regards the phrase "that is constituted and operated exclusively to administer or provide retirement or similar benefits" included in subdivision i) of the definition of "recognised pension fund" in proposed Art. 3(1) j):*** Is the word "exclusively" too restrictive given the normal operations of a pension fund? If yes, please describe the operations that might not be covered, taking into account the fact

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[2] See, e.g., the U.K.-Switzerland Tax Treaty, which defines "pension scheme" to mean "any plan, scheme, fund, trust or other arrangement established in a Contracting State which is: (a) generally exempt from income taxation in that State; and (b) operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements".

[3] See, e.g., the U.K. treaties with Belgium, Canada, the Netherlands, and Spain, which refer to "pension schemes (other than a social security scheme) registered under Part 4 of the Finance Act 2004, including pension funds or pension schemes arranged through insurance companies and unit trusts where the unit holders are exclusively pension schemes".

[4] See, e.g., Article IV(1)(b) of the U.S.-Canada Tax Treaty, which provides that: "The term `resident' of a Contracting State is understood to include… a trust, organization or other arrangement that is operated exclusively to administer or provide pension, retirement or employee benefits … that was constituted in that State and that is, by reason of its nature as such, generally exempt from income taxation in that State." See also Article 4(3)(a) and 3(1)(o) of the U.S.-U.K. Tax Treaty, which provide, respectively, that "The term `resident of a Contracting State' includes … a pension scheme" and "the term `pension scheme' means any plan, scheme, fund, trust or other arrangement established in a Contracting State which is: (i) generally exempt from income taxation in that State; and (ii) operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements."

[5] See, e.g., Article 10(4)(c) of the Canada-United Kingdom Tax Treaty for an example of a provision that allows the competent authorities to agree to treat additional pension plans as "recognised pension plans".

that the subparagraph refers not only to "retirement benefits" but also to "similar benefits"?

We are somewhat concerned that the use of the word "exclusively" in proposed Article 3(1)(j)(i) may be too restrictive, notwithstanding the fact that the subparagraph refers not only to "retirement benefits" but also to "similar benefits". We note that the proposed Commentary indicates that the term "retirement benefits" is "broad enough to cover one or more payments made at or after retirement to a self-employed person even if these payments are not made in the form of regular pension payments", and that examples of "similar benefits" would include "payments made as a result of the death or invalidity of an individual". We also note, however, that the OECD's publication "*Private Pensions: OECD Classification and Glossary"* indicates that many plans "cover many other risks in addition to old-age pensions including, survivor's, disability, sickness, maternity, adoption, and unemployment benefits".[6]

Suggestion: The Association therefore suggests replacing "exclusively" with "principally" in order to avoid the possibility that minor purposes other than "retirement or similar benefits" would disqualify a fund from classification as a "recognised pension fund".

c) ***As regards the phrase "similar benefits" included in subdivision i) of the definition of "recognised pension fund" in proposed Art. 3(1) j):*** Are there examples of "benefits" that are typically granted by pension funds that would not be covered by the phrase "similar benefits"? If yes, please describe these benefits?

See our comments under item (b), above.

d) ***As regards the phrase "that is constituted and operated exclusively to invest funds for the benefit of entities or arrangements" included in subdivision ii) of the definition of "recognised pension fund" in proposed Art. 3(1) j):*** Is the word "exclusively" too restrictive given the normal operations of an intermediary that invests on behalf of pension funds and, in particular, the possibility that these operations would include activities that are not related to the investment of funds and the possibility that non-resident pension funds would be investing through such an intermediary? If yes, please describe the operations that might not be covered?

For reasons similar to those outlined under item (b), above, the Association is somewhat concerned that the use of the term "exclusively" could be overly restrictive in this context. One example of this concern relates to so-called "81-100 group trusts"[7] which are generally used as a vehicle to pool the assets of U.S. qualified retirement plans but which may also include a minor amount of assets from Puerto Rican retirement plans.[8] Because large U.S. employers may have Puerto Rican subsidiaries and may have to maintain a separate Puerto Rican retirement plan for the benefit of the employees of those subsidiaries, sponsors of

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[6] Available at http://www.oecd.org/finance/private-pensions/privatepensionsoecdclassificationandglossary.htm.

[7] The name "81-100 group trust" comes from the fact that the original ruling from the U.S. Internal Revenue Service which set forth the requirements for such arrangements was Revenue Ruling 81-100.

[8] See Revenue Ruling 2014-24, which confirms the ability of 81-100 group trusts to include assets from Puerto Rican retirement plans.

group trusts like to be able to allow such employers to include in the 81-100 group trust not only the assets of the U.S. qualified retirement plans established for the U.S. employees but also the assets of the (typically much smaller) Puerto Rican retirement plan established for the employees of the Puerto Rican subsidiary. Since a Puerto Rican plan presumably would not qualify under proposed Article 3(1)(j)(i) (i.e., on the grounds that it is not established in the United States), an 81-100 group trust that included a Puerto Rican plan would appear not to be constituted and operated "exclusively" to invest funds for the benefits of entities or arrangements referred to in Article 3(1)(j)(i).

Suggestion: The Association therefore recommends that the term "exclusively" in proposed Article 3(1)(j)(ii) be replaced with "principally".[9] The Association further notes, however, that any terminology used in this definitional provision may need to be coordinated with the requirements, if any, imposed by a Limitation on Benefits or other anti-abuse provision in the relevant treaty. This is because the latter provisions may, for example, accommodate a certain level of participation by third country funds in the types of group arrangements or entities described in proposed Article 3(1)(j)(ii), and that policy should not be undercut by the definitional language used in Article 3(1)(j)(ii).

Additional comments

If States introduce the proposed definition of "recognised pension fund" into their treaties, the Association suggests that the OECD recommend that it would be a matter of good practice for treaty partners to enter into a mutual agreement or memorandum of understanding to confirm the treatment of specific categories of pension vehicles in their States under the new definition, in order to eliminate any uncertainty as to whether those vehicles satisfy the new definition.

While the Association appreciates that the Discussion Draft has as its objective to provide certainty to pension funds that they can satisfy the residence requirement of treaties, we note that paragraph 8.6 of the existing Commentary on Article 4 of the OECD Model states that "most States" already agree that pension funds can qualify as "residents". It therefore appears that the Discussion Draft's "solution" may be needed only in a minority of States. Depending on how some of the issues described in our comments above are resolved, we note that the introduction of new language regarding "recognised pension funds" could create new limits on the extent to which pension funds would be treated as residents of the States where they are established, including by those States that already treat pension funds as residents of their treaty partner States. The Association therefore suggests that the OECD make the proposed new definition a part of the Model to be used only by those States that

[9] We note that comparable less restrictive language can be found in a number of treaties. See, e.g., Article 3(1)(l) of the 2015 United Kingdom-Croatia Tax Treaty (which defines "pension scheme" to mean "any scheme or other arrangement established in a Contracting State which: (i) is generally exempt from income taxation in that State; and (ii) operates principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements"); paragraph 2 of the 2009 Protocol to the Switzerland-United Kingdom Tax Treaty (which defines "pension scheme" in a similar way); Article 3(1)(k) of the 2006 U.S.-Belgium Tax Treaty (which defines "pension fund" to mean "any person established in a Contracting State that is: i) operated principally: A) to administer or provide pension or retirement benefits; or B) to earn income for the benefit of one or more arrangements described in A)" and which meets certain other requirements).

would not otherwise recognize pension funds established in their treaty partner States as residents of the latter States, so that treaties between States that already share the majority view would not have to introduce the new definition.

As you know, the Association filed comments with the OECD in respect of BEPS Action 6 on January 9, 2015 and June 16, 2015 in which we addressed the problems facing pension funds seeking treaty benefits to which they are duly entitled. As indicated in those letters, while resolution of the treaty residence of pension funds would be a positive step, there remain very serious issues concerning the practical aspects of pension funds' satisfaction of the procedural requirements often imposed on them by treaty country tax administrations, particularly under the increasingly prevalent anti-abuse provisions being introduced into treaties, including various Limitation on Benefits tests and other provisions. We wish to stress the importance of addressing those practical issues as a matter of priority if there is to be any hope of avoiding a continuing deterioration of the climate for providing treaty benefits to pension funds. The Association is in the process of reviewing the Discussion Draft on Treaty Entitlement of Non-CIV Funds released on March 24, 2016, and we will provide separate comments on that Discussion Draft to the extent we feel they are needed to address these concerns.

Finally, in its previous comments, including its letter of July 26, 2013 in relation to the OECD's initiative with respect to the Common Reporting Standard, the Association stressed the importance of making near-term progress on the implementation of the OECD's TRACE (Treaty Relief and Compliance Enhancement) Project. We wish to emphasize the importance of that goal once again, as elimination of legal barriers to pension funds' access to treaty benefits (e.g., the "residence" requirement) will be meaningless if no progress is made on eliminating the ever-increasing procedural impediments, and implementation of the TRACE recommendations would be the best possible near-term step that could be taken toward that goal.

APPENDIX 1

Announcement 2012-21

DATED MAY 7, 2012

Countries: United States; Germany
Official Citations: Announcement 2012-21
Tax Analysts Citations: Doc 2012-9508
Related Treaty Texts:
U.S.-Germany: 1989 Income and Capital Tax Convention (Doc 93-31206)
U.S.-Germany: 2006 Protocol to the 1989 Convention (Doc 2006-10666)
U.S.-Germany: 2012 Competent Authority Agreement (Doc 2012-7762)

SUMMARY BY TAX ANALYSTS
IRS ANNOUNCES AVAILABILITY OF 2012 GERMANY-U.S. COMPETENT AUTHORITY AGREEMENT

The IRS has announced (Announcement 2012-21, 2012-19 IRB 898) that the U.S. and German competent authorities on March 19 reached a mutual agreement on the eligibility of certain pension arrangements for tax exemption under the Germany-U.S. income tax treaty.

U.S.-Germany Agreement on Pensions

The following is a copy of the Competent Authority Agreement ("the Agreement") entered into on March 19, 2012, by the Competent Authorities of the United States and Germany, regarding the eligibility of certain pension arrangements for benefits under Article 10(3)(b) of the Convention Between the United States of America and Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, together with a related Protocol signed on August 29, 1989, and amended by the Protocol signed on June 1, 2006.

The text of the Agreement is as follows:

COMPETENT AUTHORITY AGREEMENT

The Competent Authorities of the Federal Republic of Germany and the United States of America hereby enter into the following agreement (the "Agreement") regarding the eligibility of certain pension arrangements for benefits under paragraph 3(b) of Article 10 (Dividends) of the Convention Between the United States of America and Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, together with a related Protocol signed on August 29, 1989, and amended by the Protocol signed on June 1, 2006 (the "Treaty"). The Agreement is entered into under paragraph 3 of Article 25 (Mutual Agreement Procedure) of the Treaty.

It is understood that for purposes of the Agreement, the term "Article" refers to an Article of the Treaty.

Article 10(3)(b) provides that dividends shall not be taxed in the Contracting State of which the company paying the dividends is a resident if the beneficial owner of the dividends is a pension

fund that is a resident of the other Contracting State, provided that such dividends are not derived from the carrying on of a business, directly or indirectly, by such pension fund.

Article 10(11) provides that for purposes of Article 10, the term "pension fund" means any person that: (a) is established under the laws of a Contracting State; (b) is established and maintained in that Contracting State primarily to administer or provide pensions or other similar remuneration, including social security payments, disability pensions and widow's pensions or to earn income for the benefit of one or more of such persons; and (c) is either, in the case of the United States, exempt from tax in the United States with respect to the activities described in subparagraph (b) or, in the case of Germany, a plan the contributions to which are eligible for preferential treatment under the Income Tax Act.

Paragraph 8(b) of the Protocol to the Treaty, as amended by the Protocol signed on June 1, 2006, provides that in the case of Germany, it is understood that Article 10(3)(b) applies to the person treated as the owner of the assets of the pension fund under section 39 of the Fiscal Code, provided the dividends may only be used for providing retirement benefits through such fund.

In order to provide certainty for taxpayers, the competent authorities of Germany and the United States clarify the treatment of a contractual trust arrangement (CTA) established by an employer to hold assets set aside to fund the employer's simple employer sponsored pension plan (SESP). Provided that the SESP meets all of the requirements set out in section 6a of the German Income Tax Act and that the assets of the CTA are treated as owned by the employer under section 39 of the German Fiscal Code, then dividends derived by the CTA are eligible for benefits under Article 10(3)(b), if all other requirements of the Treaty are satisfied. In such a case, the employer that establishes the CTA shall make the claim for benefits under Article 10(3)(b).

The competent authorities of Germany and the United States also clarify that the term "pension fund" within the meaning of Article 10(11) includes the following entities and that dividends derived by such entities are eligible for benefits under Article 10(3)(b), as if the entity is the beneficial owner of the dividends, if all other requirements of the Treaty are satisfied:

1. A special German investment fund to which the provisions of the German Investment Act (Investmentgesetz) apply, provided such fund is established exclusively to hold the assets of one or more of the following:

    a. A pension fund within the meaning of Article 10(11) that is established in Germany, or

    b. A CTA established by an employer to hold assets set aside to fund the employer's SESP provided the assets of the CTA are treated as owned by the employer under section 39 of the Fiscal Code.

2. A group trust described in IRS Revenue Ruling 81-100, as modified by IRS Revenue Rulings 2004-67 and 2011-1, provided that all of its participants are pension funds within the meaning of Article 10(11) that are established in the United States.

3. A common trust fund (within the meaning of Internal Revenue Code section 584) provided that all of its participants are pension funds within the meaning of Article 10(11) that are established in the United States.

In the case of an entity described in paragraph 1), the investment management company (Kapitalanlagegesellschaft) shall make the claim for benefits under Article 10(3)(b) on behalf of the investment fund. In the case of entities described in paragraphs 2) or 3), the trustee of the group trust or common trust fund, as the case may be, shall make the claim for benefits under Article 10(3)(b) on behalf of the group trust or common trust fund.

Agreed to by the undersigned competent authorities:

Michael Danilack U.S. Competent Authority

[Name] German Competent Authority

APPENDIX 2

Challenges in Characterizing a German Contractual Trust Arrangement

BY ROSEMARIE PORTNER ON JUN. 10, 2013

Countries: Germany
WTD Citations: 2013 WTD 111-18
Tax Analysts Citation: Doc 2013-12639

SUMMARY BY TAX ANALYSTS Rosemarie Portner explains how a German contractual trust arrangement works.

Rosemarie Portner is a lawyer/tax adviser with Deloitte & Touche in Düsseldorf.

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A contractual trust arrangement (CTA) constitutes one of several diverse German pension funding vehicles. Surprisingly, the term "contractual trust arrangement" is used for German tax purposes; it is not, what might be assumed, the translation of a German term. But don't get misled -- German law still does not acknowledge the concept of a trust.

What Is a CTA Used For?

A CTA is used within the framework of German occupational pension plans in which the employer company makes a direct pension promise to its employees (*Direktzusage*). According to that type of German pension scheme, which is one of the five types of German pension schemes, the pension grant is internally funded by the employer -- the pension liabilities are recognized on the employer company's balance sheet through a provision for pension liabilities that must be proportionally built up (section 6a of the German Income Tax Act (Einkommensteuergesetz)). Thus, a company's pension assets and business assets are integrated and not segregated. The direct (unfunded) company promise is widely used in Germany, especially for high-level executives, because it leads to deferred taxation until pension disbursements are made at generally unlimited amounts.

The purpose of a CTA is to allow the employer company to net the pension obligation with the pension assets for commercial balance sheet purposes. Taxwise, a netting is not permitted. Thus, the CTA can be viewed as an off-balance-sheet vehicle for pension liabilities. Also, the employee will be protected against the employer company's insolvency in addition to protection they receive from the pension security association (*Pensionssicherungsverein*, or PSV). The PSV is an independent entity established by the Confederation of German Employers' Associations, the Confederation of German Industry, and the Association of Life Insurance Companies. All employers who guarantee pension disbursements are required to become contributing members of the PSV.

The Importance of CTAs

First, when the trustee to a CTA invests the contributions received from the employer company as the trustor to a CTA in shares in foreign corporations or debt instruments (for example, bonds) and thus generates foreign-source dividends or interest that is subject to withholding tax abroad, it must be determined whether the CTA trustee or the employer company as the trustor is regarded as the beneficial owner and thus entitled to claim the treaty benefits. The issue gets even more challenging when the employer company as the trustor resides in another country than the trustee. A CTA, for example, may be established for the benefit of employees working in a German

branch of a foreign employer corporation in connection with a company pension granted to these employees. In that case, different tax treaties may apply that may provide for different withholding tax rates for dividends or interest applicable in the country of source, or provide for specific rules that apply to pension funds.

Second, internationally mobile employees who are assigned to a host country often continue their participation in a German occupational company pension scheme during their assignment abroad. The benefit from a company pension may be includable in taxable gross employment income according to the host country tax law and, generally, be taxable there according to a tax treaty. Or, taxation of the benefit from an occupational company pension may be deferred according to the host country's tax law until pension disbursements are made, at a time when the assigned employee may have returned to the home country. When Germany is the home country and the employee was granted an unfunded company pension promise (*Direktzusage*) from its German employer, the fringe benefit is deferred for German tax purposes until pension disbursements are made and taxed at that point as income from dependent personal services. This applies regardless of whether the employer company has set up a CTA. However, according to the national tax law and tax rules in the host country, a CTA may trigger immediate taxation of the benefit from the pension grant in the hands of the employee. Thus, double taxation may occur if the pension disbursements are fully taxed as income from dependent personal services in Germany after the employee's return.

How Does a CTA Work?

A CTA is created through a fiduciary contract (*Treuhandvertrag*) between the employer company as trustor (*Treugeber*) and a legal entity established by the employer company (for example, a registered association, a limited liability company, or a foundation) as the trustee (*Treuhänder*). The provisions of the German Civil Code (Bürgerliches Gesetzbuch) governing labor contracts (sections 662 et seq.) constitute the legal basis. Thus the CTA is not a legal entity as such but constitutes a contractual arrangement between two contracting parties, the employer company as the trustor and the legal entity established by the employer company as the trustee.

The trustor transfers assets to the trustee who acquires legal title in the assets. The term "fiduciary" is not defined in German law. According to German jurisprudence the trustee must strictly comply with the trustor's instructions and is not attributed any discretion at all. The employer company gives instructions regarding the investment of the pension assets and issues investment guidelines with which the trustee must comply. The trustor bears the economic risk of a decrease of the assets' value and benefits from an increase of the assets' values. A fiduciary is acknowledged for German tax purposes if the trustee does not constitute more than an empty shell (German Federal Supreme Fiscal Court (Bundesfinanzhof) judgment of November 24, 2009, docket no. I R 12/09).

The trustee holds the assets in an account or deposit at a financial institution that is marked as a fiduciary account/deposit. It must be clearly recognizable that the trustee acts exclusively on behalf of the trustor. The CTA assets -- consisting of assets transferred by the employer company, proceeds generated from investment of the assets, and any capital gains -- must be segregated from the trustee's assets (*Sondervermögen*).

The trustor must be entitled to claim for the return of the assets transferred, which is permitted according to a CTA if the remaining plan assets cover the total liability resulting from the pension promise, or when costs are reimbursed by the employer company.

Administrative Fiduciary

An "administrative fiduciary" (*Verwaltungstreuhand*) is assumed when the trustor concludes a contract that mandates the trustee to manage and administer assets which the employer company

transfers to the trustee. Such an administrative fiduciary is established by the employer company for ease of administration of a company pension or outsourcing of the asset management. The main purpose of a CTA is, however, to create plan assets that according to accounting rules and standards (for example, international accounting standards, international financial reporting standards, German generally accepted accounting principles) can be offset against the employer's pension obligation. A CTA permits for accounting purposes a netting of the pension obligation with the plan assets. Further, the plan assets are no longer accessible to the employer or the employer's creditors but are set aside exclusively to serve the pension obligations. The type of occupational pension scheme as a direct company promise, however, remains unchanged.

According to the German Fiscal Code (Abgabenordnung) (section 39, paragraph 2, no. 1, second sentence), the assets a trustee holds in its own name but on behalf of the trustor are for tax purposes allocated to the trustor. Accordingly, the trustor is taxed with the proceeds generated through investment of the assets transferred to the trustee (section 20(5), second sentence of the German ITA).

Thus, German income tax law recognizes the pension assets segregated through transfer of title to the trustee as the company's (trustor's) assets. The trustor is regarded as the economic owner of the assets that are legally transferred to the trustee and generally entitled to claim for the tax relief according to a tax treaty if the deposit is marked as a fiduciary deposit. Accounting standards treat the assets held by the trustee as pension plan assets.

Double-Sided Fiduciary

The administrative fiduciary may be expanded by an additional "protective fiduciary" (*Sicherungstreuhand*) that protects the employee's accrued rights and claims for pension disbursements against the employer company's insolvency. The administrative fiduciary together with the protective fiduciary is known as a "double-sided fiduciary" (*Doppelseitige Treuhand*). The fiduciary contract constitutes regarding the protective fiduciary a contract for the benefit of a third party (section 328 of the German Civil Code) with the employee being the third party. The protective fiduciary thus entitles the employee to claim pension disbursements to be made from the segregated pension assets. The employee's claim cannot be revoked without the employee's consent. That claim is directed against the trustee under the suspensive condition of the employer company's insolvency. When the suspensive condition is not met, the employee's right to claim pension disbursements is solely directed against the employer company as the trustor. The employer makes the pension disbursements but is reimbursed by the trustee. In practice, the flow of the pension disbursement may be shortened in a way that the trustee directly pays pension disbursements to the employee on behalf of the employer.

According to German general principles that govern the taxation of income, the employee's taxation is deferred until pension disbursements are made because the employee acquires a mere company promise as opposed to a direct claim for pension disbursements against a third party (for example, a life insurance company or pension fund) that the employee could enforce independently from the employer. The employee's taxation is deferred even though the employee is protected against the employer company's insolvency by the PSV. Nor does the claim under the suspensive condition of the employer's insolvency trigger a taxable event for the employee, neither when the CTA is set up nor when the employer's insolvency occurs (section 3, no. 65, lit. (c) of the German ITA). The employee's taxation remains deferred until pension disbursements are made and at that time the employee is taxed with employment income for German tax purposes.

Anglo-American Pension Trust and CTAs

German civil law does not acknowledge the concept of a trust as it is known in Anglo-American countries and that involves three parties -- the settlor, the trustee, and the beneficiary. However, the German fiduciary as a contractual arrangement between the trustor (*Treugeber*) and the trustee

(*Treuhänder*) has a long-standing tradition. The use of the term "contractual trust arrangement" for a fiduciary contract is confusing in an international context in connection with Anglo-American trusts, especially when the CTA is referred to as an entity that might or might not be entitled to claim for treaty benefits applicable to dividends and interest, for example. The question should be whether the trustee or the trustor would be entitled to claim for treaty benefits.

The double-sided CTA consisting of an administrative and a protective fiduciary, however, comes close to an Anglo-American trust, yet there are differences:

- The fiduciary (*Treuhand*) is established on the basis of the fiduciary contract that permits the trustee (*Treuhänder*) to act in its own name but in the trustor's (*Treugeber*) interest; the trustee, being not more than an empty shell, must strictly comply with the trustor's instructions and cannot exercise any discretion regarding the investment of the assets or the determination of the beneficiaries or their survivors.
- In a CTA, the trustee (*Treuhänder*) is established as a legal entity by the employer company as the trustor to which assets are outsourced; the pension assets serve exclusively the purpose of meeting the employer company's pension obligation and are not accessible for the employer company's creditors.
- The pension obligation, however, remains primarily with the employer company.
- The CTA primarily serves the employer company to segregate plan assets, thus permitting a netting with the employer's pension obligation resulting from a pension promise in order to offset the pension liability with the plan assets.
- The proceeds from the invested separated fiduciary assets (pension assets) are -- for German tax purposes -- allocated to the employer company as the trustor who is deemed to be the economic owner of the pension assets.
- The employee acquires a right as a third party benefiting from the fiduciary contract under the suspensive condition of the employer company's insolvency; in the case of the employer company's insolvency, the claim for pension disbursements is directed against the trustee who satisfies the claims out of the pension assets.

The pension trust may be more comparable with one of the four German pension schemes when a separate legal entity is obligated to make pension disbursements to the employee rather than the unfunded company pension, in which the employer company primarily remains obligated to provide pension disbursements. This does not necessarily mean, however, that contributions to a pension trust would trigger immediate taxation at the level of the employee, as is the case when the employee acquires a direct and separately enforceable claim against a life insurance company, a pension fund, or as a pension pool (*Pensionskasse*). The particular facts and circumstances had to be evaluated, especially taking into account the scale of discretion allocated to the trustee of a pension fund in order to determine whether the employee acquires a direct, irrevocable claim for pension disbursements that the employee could enforce independently and without the employer company's cooperation.

Whether a German unfunded company pension promise for which a CTA is established leads to a deferred taxation or triggers immediate taxation at the level of the employee in the host country must be determined based on the host country's tax law; the above elaborations may be helpful to better understand how a CTA works.

Treaty Benefits for a CTA

For German tax purposes, the employer company being the trustor to a CTA is entitled to claim relief from tax withheld on dividends and interest the trustee receives from investments in foreign equity or debt instruments. However, the employer company does not meet the criteria of a pension fund. The trustee meets the criteria of a pension fund but is not the beneficial owner of the investment income. The claim for application of tax treaty benefits becomes especially

challenging when pension funds enjoy more generous treaty benefits than the employer company as the trustor would enjoy.

This is true when the trustee to a CTA receives dividends from a U.S. corporation. Under article 10(3)(b) of the Germany-U.S. tax treaty of 1989, as amended by the 2006 protocol, dividends are not taxed by the country of source if the beneficial owner of the dividends is a pension fund residing in the other contracting state unless the dividends are derived from a business directly or indirectly carried on by the pension fund. The term "pension fund" is defined in article 10(11) as any person organized under the laws of the United States or Germany that is established and maintained to primarily administer or provide pension or other similar remuneration. Also, in the case of the U.S., the pension fund must be exempt from tax in the U.S.; and in the case of Germany, it must be a pension scheme the contributions to which are eligible for preferential treatment under the German ITA. Preferential treatment under the German ITA is granted to three of the five German pension schemes when the contributions trigger immediate taxation for the employee, but a tax exemption is granted at a limited amount if further conditions are met. The unfunded company pension promise, however, is not granted preferential treatment. The tax deferral results from application of the general tax principle governing the taxation of income.

Paragraph 8b) of the protocol regarding article 10(3) (dividends) of the Germany-U.S. tax treaty states:

> subparagraph b) of paragraph 3 of Article 10 applies to the person treated as the owner of the assets of the pension fund under section 39 of the Fiscal Code, provided the dividends may only be used for providing retirement benefits through such fund.

The U.S. and the German competent authorities reached a consultation agreement (article 25(3) of the Germany-U.S. tax treaty) dated March 19, 2012, to clarify that the term "pension fund" includes a CTA. The competent authority agreement clearly states, however, that the employer company as the trustor can claim the benefits of article 10(3)(b). From there it follows that the employer company as trustor is entitled to claim an exemption from withholding tax on dividends according to article 10(3)(b) of the Germany-U.S. tax treaty. I believe that the trustee must meet the specific preconditions set out in article 28(2)(e) of the Germany-U.S. tax treaty (limitation on benefits). Accordingly, an exemption from withholding tax requires that either more than half of the beneficiaries of a CTA are individuals who are residing in Germany or that the trustor is entitled to claim the tax treaty benefits of the Germany-U.S. tax treaty.