

Comments on E/C.18/2020/CRP.9 (CIVs)

-Rajat Bansal, Member, UN Committee

1. Insertion of definition of 'recognised pension fund' in Article 3.1 of UN Model as per OECD Model (Para 5/page 4): These changes are being proposed following the OECD Model 2017 and Commentary thereto. The changes are for catering to those pension funds which formally constitute a separate person under domestic law of a State. OECD Commentary paragraph 1.4 on Article 3 states that the effect of definition and reference of term in Article 4.1 will depend to a large extent on domestic law and on legal characteristics of the pension funds in each Contracting State. In most countries, pension funds would not be considered separate person. There may not be enough justification to add this definition in Model and at best it could be added as an option in Commentary for bilateral negotiations.

2. CIV qualifying as 'Beneficial Owner' of income received (Para 9.7 of proposed UN Commentary by quoting paragraph 28 of OECD Commentary on Article 1/page 8 of CRP9): It is stated that 'Accordingly, a vehicle that meets the definition of a widely-held CIV will also be treated as the beneficial owner of the dividends and interest that it receives, so long as the managers of the CIV have discretionary powers to manage the assets generating such income (unless an individual who is a resident of that State who would have received the income in the same circumstances would not have been considered to be the beneficial owner thereof).' As against this, the concept of 'beneficial owner' in OECD Commentary in paragraph 2 of Article 10 (now proposed to be quoted in UN Commentary) is essentially recipient of income having *right to use and enjoy the income unconstrained by a contractual or legal obligation to pass on the payment received to another person* (Para 12.4 of OECD Commentary on Article 10.2). The CIV is in general defined (para 22 of OECD Commentary on Article 1) to be widely held, holding a diversified portfolio of securities and subject to investor protection regulation in country where established. These aspects do not have any bearing on right to use and enjoy income unconstrained by contractual or legal obligation to pass on the payment to another person. The other aspect of managers of CIV having discretionary powers to manage assets generating income in question does mean that the CIV can use the income for making further investments but it cannot enjoy it. Ultimately, income has to be passed on to the investors, who alone would have right to use and enjoy the income unconstrained by legal or contractual obligations. Thus, while the CIV may have more rights than an agent, nominee, conduit company acting as a fiduciary or administrator, it does not have what it takes to become 'beneficial owner' in terms of criteria in Commentary on Article 10.2. I had raised the foregoing point before the Subcommittee through written comments. On above comments, Secretariat made following comments for purpose of discussion in Subcommittee's meeting dated 4th may, 2020:

“The application of the concept of “beneficial owner” to CIV is one of the treaty technical difficulties referred to in paragraph 9.2, 9.3 and 9.7. It is therefore clear that the view expressed in paragraph 28, which ensures that the benefits of Article 10, 11, 12 and 12A are not systematically denied to all CIVs, is not an absolute rule. Also, the quoted paragraph 28 should be read together with the following paragraph 29 which indicates that “[b]ecause these principles are necessarily general, their application to a particular type of CIV might not be clear to the CIV, investors and intermediaries”.

Having said that, the exception in the last part of the final sentence of paragraph 28 should be sufficient to address any concern: according to that exception, a CIV would not be a beneficial owner if “individual who is a resident of that State who would have received the income in the same circumstances would not have been considered to be the beneficial owner thereof”. “

Finally, it is important to remember that paragraph 9.7, which precedes the quoted paragraph 28, indicates that the quoted OECD paragraph is “relevant”. This formulation is different from the typical formulation indicating that UN Committee considers the paragraph to be “applicable”.

It was decided through voting by majority of those present during Subcommittee meeting on 4th May, 2020, that Secretariat’s view should prevail. My comments have not been included in CRP9 sent to Committee. I still have concerns in the matter:

- (i) Para 28 lays down an absolute rule for CIVs fulfilling criteria of ‘widely held’ and ‘managers having discretionary powers to manage the assets generating income’. These criteria cannot be said to fulfil criteria for BO in Article 10.2 of OECD Commentary.
- (ii) The sentence in para 29 of OECD Commentary is rather justifying need to clarify (as in para 28) to make every CIV (widely held/manager having discretion to invest) as ‘beneficial owner’.
- (iii) The final part of last sentence of para28 in parentheses i.e. “individual who is a resident of that State who would have received the income in the same circumstances would not have been considered to be the beneficial owner thereof” needs to be explained in UN Commentary, as it appears to create a contradiction. An individual who receives income and passes it on like a CIV, does not have right to enjoy it. So he would not be regarded as beneficial owner.
- (iv) Fine distinction between ‘relevant’ vs ‘applicable’ may not be clear to developing countries. It should be made clear, if there is any intention in using ‘relevant’ and if it is a standard practice.

In view of this, important matter may be discussed at Committee level.

3. Inclusion of ‘Recognised Pension Fund’ in paragraph 1 of Article 4 as a ‘resident’ (para 10 of CRP9/page23 onwards): ‘Recognised pension fund’ (as defined in Article 3) is proposed to be regarded as ‘resident’ without necessarily satisfying the condition of ‘liable to tax’. Entity or person established to administer retirement benefits etc. and treated as a separate

person under taxation laws of Contracting State is defined as ‘recognised pension fund’ under Article 3. Every such entity would become ‘resident’ under Article 4.1 by putting it in last limb of paragraph 1 of Article 4 along-with State, political sub-division or local authority, without condition of ‘liable to tax under laws of that State on criterion of domicile, residence, place of management etc’ being applicable. OECD Commentary in paragraphs 8.6 to 8.13 on Article 4.1 is proposed to be referred to by omitting earlier paragraphs. Paragraph 8.8 states that to the extent conditions of the definition are met, the fund will itself constitute resident of Contracting State because in many countries, the fund may be liable to tax therein by reason of criteria in paragraph 1 of Article 4, *or if that is not the case, because of the specific inclusion of the term ‘recognised pension fund’ in paragraph 1.* In essence, the recognised pension fund is being deemed ‘resident’ with no necessity of it being liable to tax. This position does not appear to be acceptable technically. Paragraph 8.6 of OECD Commentary states that ‘Most member countries have long considered that a pension fund established in a Contracting State is a resident of that State regardless of the fact that it may benefit from a limited or complete exemption from taxation in that State.’ This seems to be the reason driving the changes in OECD Model. However, this does not seem to be case with most member countries of UN.

On above comments, Secretariat made following comments for purpose of discussion in Subcommittee’s meeting dated 4th may, 2020:

‘These comments seem to suggest that the UN Model should not clarify the treaty entitlement of pension funds. That, however, seems contrary to what the Subcommittee has decided to do. It should be noted that paragraph 6 of the Commentary on Article 4 of the existing UN Model already quotes paragraph 8.6 of the previous version of the OECD Model, according to which

“... pension funds, charities and other organisations may be exempted from tax, but they are exempt only if they meet all of the requirements for exemption specified in the tax laws. They are, thus, subject to the tax laws of a Contracting State. Furthermore, if they do not meet the standards specified, they are also required to pay tax. Most States would view such entities as residents for purposes of the Convention.”

However, it also quotes paragraph 8.7, according to which:

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

These opposing views, which seem to require countries that do not consider that pension funds qualify as residents to address the issue in their treaties, are a source of considerable uncertainty. The proposal to clarify the issue of the residence of pensions funds through specific

treaty wording therefore seems the best way to deal with a problem that is an important practical one.'

It was decided through voting by majority of those present during Subcommittee meeting on 4th May, 2020 that Secretariat's view should prevail. My comments have not been included in CRP9 sent to Committee. I am not satisfied with Secretariat's explanation and of the view that this matter needs discussion at Committee level. UN Committee should not adopt something, which is technically an issue. Paragraphs 8.6 and 8.7 of OECD Commentary referred to in existing UN Commentary are on aspect whether being exempt is regarded as 'liable to tax'. That is a different aspect. Most countries regard being exempt and subject to tax as meeting criteria of 'liable to tax'. However, here what is proposed is to regard recognized pension funds as resident under Article 4.1 even if they are not liable to tax in first place.

To sum up this point, it is suggested that inclusion of proposed change in Article 4 in respect of 'recognised pension funds' as per OECD updates of 2017 be not carried out in the UN Model Convention. If at all, it may be provided as an option in the Commentary. This matter may be discussed by the Committee.