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Update of the UN Model Double Taxation Convention between Developed and Developing Countries – Collective Investment Vehicles, Pension funds and REITs

Note by the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries

Summary

This note is presented for DISCUSSION AND APPROVAL at the twenty-first session of the Committee.

It includes a revised version of the draft changes to the Articles and Commentary of the UN Model that the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries that were included in note E/C.18/2020/CRP.9, which was discussed at the twentieth session of the Committee.

At its twenty-first session, the Committee is invited to discuss and approve the changes to the UN Model included in this note.

Introduction

1. At its twentieth session (online meeting held on 20-26 June 2020), the Committee discussed note E/C.18/2020/CRP.9, which included the draft changes to the Articles and Commentary of the UN Model that the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries prepared in accordance with the decision taken by the Committee at its nineteenth session (Geneva, 15-18 October 2019), when note E/C.18/2019/CRP.20 on tax policy considerations related to the tax treaty treatment of collective investment was presented.

2. During that discussion, it was agreed that, subject to the two minor changes included in note E/C.18/2020/CRP.27 and to a correction agreed to during the meeting, note E/C.18/2020/CRP.9 would be released for public comments and these comments, together with written comments received from Mr. Rajat Bansal in advance of the 20th session, would be discussed at the Subcommittee's next meeting. The discussion draft that included the corrected version of the proposals was released on 22 July with a deadline of 21 August for comments.

3. At its online meeting of 31 August and 1-2 September 2020, the Subcommittee discussed each of the comments received on the discussion draft and concluded that no changes should be made to the proposals included in that discussion draft. It also agreed that the comments previously submitted by Rajat Bansal should be presented as minority views in the Commentary included in these proposals.

4. This note includes, with a few corrections to the numbering, the revised version of the proposed changes to the UN Model that were included in the discussion draft (that version incorporated the two minor changes included in note E/C.18/2020/CRP.27 as well as the correction agreed during the twentieth session). It also includes, in shaded boxes, proposed minority views that reflect the comments previously submitted by Rajat Bansal. These comments, as well as the comments received on the discussion draft, are included in the Annex.

5. At its twenty-first session, the Committee is invited to discuss and approve the changes to the UN Model included in this note.

Possible Changes to the UN Model related to CIVs, Pension Funds and REITs

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1. Draft changes to the articles of the UN Model

Article 1

1. It is proposed to add the following new paragraph 4 and footnote to Article 1 of the UN Model in order to stress the importance of addressing the issue of collective investment vehicles while not recommending any specific approach and leaving flexibility to treaty negotiators to adopt, omit, amend or supplement the various alternative provisions that will be included in the Commentary:

> 4. *[Provision dealing with the application of the Convention to collective investment vehicles]*[1]

[*Footnote 1*] Various forms that such a provision could take are discussed in the section "Collective Investment" in the Commentary on Article 1. As discussed in that section, the domestic tax rules applicable to various forms of collective investment vehicles in the Contracting States, disparities in the importance of investment by such vehicles in each of these States as well as other policy or administrative considerations may not justify the inclusion of a provision on collective investment vehicles in a bilateral tax treaty or may require different provisions aimed at different categories of such vehicles.

Article 3

2. It is proposed to add the following new definition of "recognized pension fund" in paragraph 1 of Article 3, as was done in the OECD Model in 2017:

> (*g*) the term "recognized pension fund" of a State means an entity or arrangement established in that State that is treated as a separate person under the taxation laws of that State and:
>
> (i) that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities, or
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> (ii) that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements to which subdivision (i) applies.

Article 4

3. It is proposed to replace paragraph 1 of Article 4 of the UN Model by the following in order to ensure that the recognized pension funds to which the above new definition applies fall within the definition of "resident of a Contracting State", as was done in the OECD Model in 2017 (and, at the same time, to replace the pronoun "his"):

> 1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of ~~his~~***that person's*** domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof

as well as a recognized pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

Article 29

4. It is proposed to make the following changes to paragraph 2 of Article 29 (the proposed changes appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

2. A resident of a Contracting State shall be a qualified person at a time when a benefit would otherwise be accorded by the Convention if, at that time, the resident is:

[(a) to (d) unchanged]

(*e*) a person, other than an individual, that

(i) is a *[agreed description of the relevant non-profit organisations found in each Contracting State]*, or

(ii) is a recognized pension fund***;***[12] ~~to which subdivision (i) of the definition of recognized pension fund in paragraph 1 of Article 3 applies, provided that more than 50 per cent of the beneficial interests in that person are owned by individuals resident of either Contracting State, or more than [__ per cent] of the beneficial interests in that person are owned by individuals resident of either Contracting State or of any other State with respect to which the following conditions are met~~

~~(A) individuals who are residents of that other State are entitled to the benefits of comprehensive convention for the avoidance of double taxation between that other State and the State from which the benefits of this Convention are claimed, and~~

~~(B) with respect to income referred to in Articles 10 and 11 of this Convention, if the person were a resident of that other State entitled to all the benefits of that other convention, the person would be entitled, under such convention, to a rate of tax with respect to the particular class of income for which benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention; or~~

~~(iii) is a recognised pension fund to which subdivision (ii) of the definition of recognised pension fund in paragraph 1 of Article 3 applies, provided that it is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in the preceding subdivision;~~

[(f) unchanged]

(*g*) ~~[possible provision on collective investment vehicles];~~ ***[a collective investment vehicle to which paragraph 4 of Article 1 applies].***[12]

[Footnote 12] ~~12 As to incorporation of such a definition, see paragraph 14 of the Commentary on Article 29.~~ ***Subparagraph (g) should only be inserted if a provision on collective investment vehicles is included in the Convention; see the footnote to paragraph 4 of Article 1.***

2. Draft changes to the Commentary on the UN Model

Commentary on Article 1

5. It is proposed to add the following new section immediately before the heading "Improper use of the Convention" in the existing Commentary on Article 1 of the UN Model in order to provide guidance on the type of provision that could be added under paragraph 4 of Article 1 and, more generally, to address tax treaty issues related to collective investment:

Collective investment

9.1 A large part of cross-border investment is done through various vehicles that allow for the pooling of investments by groups of investors.[1] Such collective investment may be done, for example, through large employer-sponsored pension funds or through various categories of funds that seek to attract savings from individuals and to invest these savings in various assets (e.g. in immovable property assets through so-called "Real Estate Investment Funds" - REITs).

9.2 Such vehicles used to channel collective investment constitute one of the largest categories of investors in foreign capital markets. A country that wants to encourage portfolio investment on its territory may therefore find it useful to clarify whether and how tax treaties will apply to such collective investment. Without such clarification, these vehicles may be reluctant to invest in a country or, if they do invest, the tax administration may have to address difficult treaty issues without a clear indication of the policy that the country has adopted in relation to these types of investors. A country should also consider, however, whether treaty-shopping concerns could arise with the use, by investors of third states, of vehicles established in states with which it concludes treaties.

9.3 Paragraph 4 is intended to remind treaty negotiators of the importance of addressing tax treaty issues that arise in the case of cross-border investment by funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established, which are referred to as "collective investment vehicles" (CIVs). These funds adopt different legal structures and may be set up, for instance, as companies, partnerships, trusts or contractual arrangements that create a joint ownership. A general policy goal of many countries is to ensure that investing through a domestic CIV should result in a tax burden that is equal to the one that applies in the case of a direct investment, i.e. an investment where the CIV would not exist and where the investor in the CIV would have acquired directly its share of the assets held by the CIV. That policy goal is achieved through different mechanisms that result in tax being paid exclusively either at the level of the CIV or at the level of the investors:

– The CIV may be set up, or treated for tax purposes, as a transparent entity: for instance, if the state where the CIV is set up treats partnerships or some trusts as transparent for tax purposes and taxes directly the partners (in the case of a partnership) or beneficiaries (in the case of a trust), no tax will be payable by the CIV and each investor in the CIV will pay tax on its respective share of the income derived through the CIV.

1 It was estimated that in 2019 the total worldwide assets invested through regulated funds amounted to over US$54.9 trillion (https://www.ici.org/pdf/2020_factbook.pdf, page 11, last visited 10 June 2020).

– The CIV may be set up as a contractual arrangement that does not create a separate entity: in such case, the CIV is not a separate taxpayer and each investor in the CIV is considered to be a joint owner of the assets held through the CIV and is taxed on its share, as joint owner, of the investment income derived from these assets.

– The tax law provides that CIVs are taxed on their income and that investors are not taxed on distributions by the CIV: in that case taxation takes place exclusively at the level of the CIV.

– The tax law provides that CIVs are taxed on their income but that distributions to the CIV investors are deductible from the CIV's tax base: in that case, while the CIV is technically taxable on its investment income, it does not, in fact, pay tax to the extent that it distributes the income that it has earned.

– The tax law provides that CIVs are taxed on their income but that investors get a credit for the tax paid by the CIVs: in that case, the tax paid by the CIV reduces the tax that the investor has to pay when it is taxed on the income from the CIV (e.g. upon distribution of that income).

The different legal structures and tax treatment of CIVs in the states in which they are established raise a number of technical issues as regards the application of the typical provisions of tax treaties.

9.4 These issues are discussed in a section of the Commentary on Article 1 of the OECD Model Convention that refers to the OECD report produced on the issue. As noted at the beginning of that section:

> 22. Most countries have dealt with the domestic tax issues arising from groups of small investors who pool their funds in collective investment vehicles (CIVs). In general, the goal of such systems is to provide for neutrality between direct investments and investments through a CIV. Whilst those systems generally succeed when the investors, the CIV and the investment are all located in the same country, complications frequently arise when one or more of those parties or the investments are located in different countries. These complications are discussed in the report by the Committee on Fiscal Affairs entitled "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" [*reproduced in Volume II of the full version of the OECD Model Convention at page R(24)-1*], the main conclusions of which have been incorporated below. For purposes of the Report and for this discussion, the term "CIV" is limited to funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established.

9.5 Given the importance of CIVs' cross-border portfolio investment in developing countries, the fact that the tax authorities of these countries may be less familiar with the tax issues raised by such vehicles and the fact that paragraphs 1 to 7 of Article 29 of the UN Model put forward specific provisions intended to address the issue of treaty shopping, which is an issue that is discussed extensively in the OECD report and Commentary, the Committee has concluded that a specific reference to a possible provision that would address the question of the application of tax treaties to CIVs would be useful.

9.6 This was done through the addition of paragraph 4. That paragraph does not, however, provide a standard form that a provision on collective investment vehicles could take. As indicated in the footnote to paragraph 4 and explained below, such a provision could take different forms depending on the policy views of both Contracting States. Also, various policy or administrative considerations may not justify the inclusion of a provision on collective investment vehicles in a

bilateral tax treaty or may require different provisions aimed at different categories of such vehicles. Some possible forms that a provision on collective investment vehicles could take are discussed in paragraphs 9.13 to 9.16 below.

9.7 If the Contracting States prefer not to address issues related to the treatment of CIVs, or of some types of CIVs, through specific treaty provisions, they will still need to consider how the other provisions of their bilateral treaty will apply to income derived by or through these vehicles. The Committee considers that the following parts of the Commentary on Article 1 of the OECD Model Convention are relevant in such cases (the changes or additional comments that appear in square brackets in the quotations included in this paragraph and in paragraphs 9.8 to 9.17 below, which are not part of the Commentary on the OECD Model Convention, have been inserted in order to provide additional explanations or to reflect the differences between the treatment of CIVs in this model and in the OECD Model Convention):

> 23. The primary question that arises in the cross-border context is whether a CIV should qualify for the benefits of the Convention in its own right. In order to do so under treaties that […] do not include a specific provision dealing with CIVs *[or do not deal with all types of CIVs]*, a CIV would have to qualify as a "person" that is a "resident" of a Contracting State and, as regards the application of Articles 10 and 11 *[as well as Articles 12 and 12A in the exceptional cases where a CIV would derive income covered by these Articles]*, that is the "beneficial owner" of the income that it receives.
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> 24. The determination of whether a CIV should be treated as a "person" begins with the legal form of the CIV, which differs substantially from country to country and between the various types of vehicles. In many countries, most CIVs take the form of a company. In others, the CIV typically would be a trust. In still others, many CIVs are simple contractual arrangements or a form of joint ownership. In most cases, the CIV would be treated as a taxpayer or a "person" for purposes of the tax law of the State in which it is established; for example, in some countries where the CIV is commonly established in the form of a trust, either the trust itself, or the trustees acting collectively in their capacity as such, is treated as a taxpayer or a person for domestic tax law purposes. In view of the wide meaning to be given to the term "person", the fact that the tax law of the country where such a CIV is established would treat it as a taxpayer would be indicative that the CIV is a "person" for treaty purposes. Contracting States wishing to expressly clarify that, in these circumstances, such CIVs are persons for the purposes of their conventions may agree bilaterally to modify the definition of "person" to include them.
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> 25. Whether a CIV is a "resident" of a Contracting State depends not on its legal form (as long as it qualifies as a person) but on its tax treatment in the State in which it is established. Although a consistent goal of domestic CIV regimes is to ensure that there is only one level of tax, at either the CIV or the investor level, there are a number of different ways in which States achieve that goal. In some States, the holders of interests in the CIV are liable to tax on the income received by the CIV, rather than the CIV itself being liable to tax on such income. Such a fiscally transparent CIV would not be treated as a resident of the Contracting State in which it is established because it is not liable to tax therein.
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> 26. By contrast, in other States, a CIV is in principle liable to tax but its income may be fully exempt, for instance, if the CIV fulfils certain criteria with regard to its purpose, activities or operation, which may include requirements as to minimum distributions, its sources of income and sometimes its sectors of operation. More frequently, CIVs are subject to tax but the base for taxation is reduced, in a variety of different ways, by reference to distributions paid to investors. Deductions for distributions will usually mean that no tax is in fact paid. Other States tax CIVs but at a special low tax rate. Finally, some States tax CIVs

fully but with integration at the investor level to avoid double taxation of the income of the CIV. For those countries that adopt the view, reflected in paragraph 8.11 of the Commentary on Article 4, that a person may be liable to tax even if the State in which it is established does not impose tax, the CIV would be treated as a resident of the State in which it is established in all of these cases because the CIV is subject to comprehensive taxation in that State. Even in the case where the income of the CIV is taxed at a zero rate, or is exempt from tax, the requirements to be treated as a resident may be met if the requirements to qualify for such lower rate or exemption are sufficiently stringent.

27. Those countries that adopt the alternative view, reflected in paragraph 8.12 of the Commentary on Article 4, that an entity that is exempt from tax therefore is not liable to tax may not view some or all of the CIVs described in the preceding paragraph as residents of the States in which they are established. States taking the latter view, and those States negotiating with such States, are encouraged to address the issue in their bilateral negotiations.

28. Some countries have questioned whether a CIV, even if it is a "person" and a "resident", can qualify as the beneficial owner of the income it receives. Because a "CIV" as defined in paragraph [9.3] above must be widely-held, hold a diversified portfolio of securities and be subject to investor-protection regulation in the country in which it is established, such a CIV, or its managers, often perform significant functions with respect to the investment and management of the assets of the CIV. Moreover, the position of an investor in a CIV differs substantially, as a legal and economic matter, from the position of an investor who owns the underlying assets, so that it would not be appropriate to treat the investor in such a CIV as the beneficial owner of the income received by the CIV. 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).

29. Because these principles are necessarily general, their application to a particular type of CIV might not be clear to the CIV, investors and intermediaries. Any uncertainty regarding treaty eligibility is especially problematic for a CIV, which must take into account amounts expected to be received, including any withholding tax benefits provided by treaty, when it calculates its net asset value ("NAV"). The NAV, which typically is calculated daily, is the basis for the prices used for subscriptions and redemptions. If the withholding tax benefits ultimately obtained by the CIV do not correspond to its original assumptions about the amount and timing of such withholding tax benefits, there will be a discrepancy between the real asset value and the NAV used by investors who have purchased, sold or redeemed their interests in the CIV in the interim.

30. In order to provide more certainty under existing treaties, tax authorities may want to reach a mutual agreement clarifying the treatment of some types of CIVs in their respective States. With respect to some types of CIVs, such a mutual agreement might simply confirm that the CIV satisfies the technical requirements discussed above and therefore is entitled to benefits in its own right. In other cases, the mutual agreement could provide a CIV an administratively feasible way to make claims with respect to treaty-eligible investors (see paragraphs 36 to 40 of the report "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" for a discussion of this issue). Of course, a mutual agreement could not cut back on benefits that otherwise would be available to the CIV under the terms of a treaty.

Proposed minority view

9.8 [One Member of the Committee] [*that wording might need to be amended based on the number of members who would support that view and of any decisions concerning minority views that may be reached by the Committee under item 3(a) of its agenda*] did not agree with the view expressed in paragraph 28 of the OECD Commentary quoted above. Th[at member] observed that the concept of "beneficial owner", as interpreted in the Commentary on Articles 10, 11, 12 and 12A refers essentially to a recipient of income *having the right to use and enjoy* the income *unconstrained by a contractual or legal obligation to pass on the payment received to another person* (see paragraph 12.4 of the OECD Commentary quoted in paragraph 13 of the Commentary on Article 10). Th[at member] considered that the fact that the managers of a CIV have discretionary powers to manage assets generating income in question means 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, according to th[at member], 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 the criteria in the Commentary on Articles 10, 11, 12 and 12A.

9.8 The Contracting States may, however, prefer to deal expressly with the technical issues identified in paragraph 9.7 above in a way that will provide for an appropriate tax treaty treatment of CIVs in the light of different policy considerations, such as the different legal forms of CIVs in two Contracting States or in the same State and the potential for treaty shopping through the use of CIVs. These considerations are discussed in the following paragraphs of the Commentary on Article 1 of the OECD Model Convention:

32. However, in negotiating new treaties or amendments to existing treaties, the Contracting States would not be restricted to clarifying the results of the application of other treaty provisions to CIVs, but could vary those results to the extent necessary to achieve policy objectives. For example, in the context of a particular bilateral treaty, the technical analysis may result in CIVs located in one of the Contracting States qualifying for benefits, whilst CIVs in the other Contracting State may not. This may make the treaty appear unbalanced, although whether it is so in fact will depend on the specific circumstances. If it is, then the Contracting States should attempt to reach an equitable solution. If the practical result in each of the Contracting States is that most CIVs do not in fact pay tax, then the Contracting States should attempt to overcome differences in legal form that might otherwise cause those in one State to qualify for benefits and those in the other to be denied benefits. On the other hand, the differences in legal form and tax treatment in the two Contracting States may mean that it is appropriate to treat CIVs in the two States differently. In comparing the taxation of CIVs in the two States, taxation in the source State and at the investor level should be considered, not just the taxation of the CIV itself. The goal is to achieve neutrality between a direct investment and an investment through a CIV in the international context, just as the goal of most domestic provisions addressing the treatment of CIVs is to achieve such neutrality in the wholly domestic context.

33. A Contracting State may also want to consider whether existing treaty provisions are sufficient to prevent CIVs from being used in a potentially abusive manner. It is possible that a CIV could satisfy all of the requirements to claim treaty benefits in its own right, even

though its income is not subject to much, if any, tax in practice. In that case, the CIV could present the opportunity for residents of third countries to receive treaty benefits that would not have been available had they invested directly. Accordingly, it may be appropriate to restrict benefits that might otherwise be available to such a CIV, either through generally applicable anti-abuse or anti-treaty shopping rules (as discussed under "Improper use of the Convention" below) or through a specific provision dealing with CIVs.

34. In deciding whether such a provision is necessary, Contracting States will want to consider the economic characteristics, including the potential for treaty shopping, presented by the various types of CIVs that are prevalent in each of the Contracting States. For example, a CIV that is not subject to any taxation in the State in which it is established may present more of a danger of treaty shopping than one in which the CIV itself is subject to an entity-level tax or where distributions to non-resident investors are subject to withholding tax.

9.9 The following version of a provision that could be included in paragraph 4 would address the considerations referred to in paragraph 9.8 above. It is based on the alternative provision found in paragraph 35 of the Commentary on Article 1 of the OECD Model, but with substantive modifications that reflect how the UN Model deals with the issue of derivative benefits, and the related issue of the definition of "equivalent beneficiary", in its Article 29:

4. Notwithstanding the other provisions of this Convention, a collective investment vehicle which is established in a Contracting State and which receives income arising in the other Contracting State shall be treated for purposes of applying the Convention to such income as an individual who is a resident of the Contracting State in which it is established and as the beneficial owner of the income it receives (provided that, if an individual who is a resident of the first-mentioned State had received the income in the same circumstances, such individual would have been considered to be the beneficial owner thereof), but only to the extent that the beneficial interests in the collective investment vehicle are owned by residents of the Contracting State in which the collective investment vehicle is established who are qualified persons within the meaning of paragraph 2 of Article 29 *[possible addition of "or by equivalent beneficiaries"]*. For the purposes of this paragraph, the term "collective investment vehicle" means, in the case of [State A], a […] and, in the case of [State B], a […], as well as any other investment fund, arrangement or entity established in either Contracting State which the competent authorities of the Contracting States agree to regard as a collective investment vehicle for purposes of this paragraph *[possible addition of a definition of "equivalent beneficiary" for the purposes of this paragraph]*.

9.10 The provision in paragraph 9.9 above and the alternatives discussed below in paragraphs 9.14, 9.15 and 9.17 operate to deem the CIV to be an individual resident of the Contracting State in which it is established with respect to the income that is receives from the other Contracting State without affecting the right of that other State to tax its own residents who have invested in that CIV. Also, these provisions clarify how the beneficial owner requirement of Articles 10, 11, 12 and 12A would apply to the collective investment vehicles to which these provisions would apply. The Committee considers that the following explanations found in the Commentary on Article 1 of the OECD Model Convention are relevant in this respect:

47. [*The provisions of the alternatives discussed in paragraphs 9.9, 9.14, 9.15 and 9.17 treat*] the CIV as the resident and the beneficial owner of the income it receives for the purposes of the application of the Convention to such income, which has the simplicity of providing for one reduced rate of withholding with respect to each type of income. As

confirmed by paragraph 3 [*of Article 1*], these provisions, however, do not restrict in any way the right of the State of source from taxing its own residents who are investors in the CIV. Clearly, these provisions are intended to deal with the source taxation of the CIV's income and not the residence taxation of its investors.

48. Also, each of these provisions is intended only to provide that the specific characteristics of the CIV will not cause it to be treated as other than the beneficial owner of the income it receives. Therefore, a CIV will be treated as the beneficial owner of all of the income it receives. The provision is not intended, however, to put a CIV in a different or better position than other investors with respect to aspects of the beneficial ownership requirement that are unrelated to the CIV's status as such. Accordingly, where an individual receiving an item of income in certain circumstances would not be considered as the beneficial owner of that income, a CIV receiving that income in the same circumstances could not be deemed to be the beneficial owner of the income. This result is confirmed by the parenthetical limiting the application of the provision to situations in which an individual in the same circumstances would have been treated as the beneficial owner of the income.

9.11 Since the provisions in paragraph 9.9 above and in paragraphs 9.14, 9.15 and 9.17 below apply notwithstanding the other provisions of the Convention, they override those of paragraph 2 of Article 1 dealing with transparent entities. Thus, although a CIV legally structured as a partnership might be treated as fiscally transparent under the domestic law of either Contracting State, it would still be that CIV, rather than the partners, that would be considered, for the purposes of the application of the Convention, as the recipient of the income entitled to treaty benefits.

9.12 The provisions in paragraph 9.9 above and in paragraphs 9.14, 9.15 and 9.17 below do not seek to provide a substantive definition of the CIVs to which they would apply. They rather provide that these CIVs would be identified through the specific cross-references to the relevant tax or securities law provisions relating to CIVs of each State that would be included in the last part of these provisions. These CIVs would typically be funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established.

9.13 The provision in paragraph 9.9 above reflects the approach put forward in paragraphs 1 to 7 of Article 29 in order to address potential treaty shopping. It therefore only applies to the extent that the beneficial interests in the collective investment vehicle are owned by residents of the Contracting State in which the collective investment vehicle is established who constitute "qualified persons" within the meaning of paragraph 2 of Article 29. Consistent with the approach put forward in Article 29, the provision recognizes that the Contracting States may wish to extend the scope of the provision to "equivalent beneficiaries" as this term is defined in subparagraph 7(*e*) of Article 29 (see the explanations provided in paragraph 20 of the Commentary on Article 29 in relation to the possible addition to Article 29 of a "derivative benefit" rule as well as the explanations of the concept of "equivalent beneficiary" in paragraphs 28 and 29 of the Commentary on Article 29). The justification for extending the scope of the provision to such "equivalent beneficiaries" is to ensure that investors who would have been entitled to benefits with respect to income derived from the source State had they received the income directly are not put in a worse position by investing through a CIV located in a third country. As noted in paragraph 37 of the Commentary on Article 1 of the OECD Model Convention, such an extension "is beneficial for investors, particularly those from small countries, who will consequently enjoy a greater choice of investment vehicles. It also increases economies of scale, which are a primary economic benefit of

investing through CIVs". The definition of equivalent beneficiary in subparagraph 7(e) of Article 29 allows the application of the provision when there are investors from third countries but without allowing its application with respect to an investor that would be an entity in a third country that would not be entitled to treaty benefits in the source State under provisions similar to those of paragraphs 1 to 7 of Article 29 (i.e. because of risks that such entity would itself be used for treaty shopping).

9.14 As recognized in paragraph 41 of the Commentary on Article 1 of the OECD Model Convention, however, while the proportionate approach put forward in the provision in paragraph 9.9 above addresses treaty-shopping concerns, the determination of the treaty entitlement of every single investor may impose a substantial administrative burden for a CIV. Paragraph 41 of the OECD Commentary goes on to suggest that "[a] Contracting State may decide that the fact that a substantial proportion of the CIV's investors are treaty-eligible is adequate protection against treaty shopping, and thus that it is appropriate to provide an ownership threshold above which benefits would be provided with respect to all income received by the CIV. Including such a threshold would also mitigate some of the procedural burdens that otherwise might arise." In the context of the UN Model, the addition of such a threshold could be achieved by adding the following to the provision in paragraph 9.9 above:

> However, if at least […] per cent of the beneficial interests in the collective investment vehicle are owned by residents of the Contracting State in which the collective investment vehicle is established who are qualified persons of that State within the meaning of paragraph 2 of Article 29 [*possible addition of "or by equivalent beneficiaries"*], the collective investment vehicle shall be treated as an individual who is a resident of the Contracting State in which it is established and as the beneficial owner of all of the income it receives (provided that, if an individual who is a resident of the first-mentioned State had received the income in the same circumstances, such individual would have been considered to be the beneficial owner thereof).

9.15 In some cases, Contracting States might simply wish to address the technical issues discussed in paragraph 9.7 above and to confirm the treaty entitlement of CIVs through a simpler provision that would not expressly address potential treaty-shopping concerns. Such a provision is proposed in paragraph 31 of the Commentary on Article 1 of the OECD Model Convention:

> 31. The same considerations would suggest that treaty negotiators address expressly the treatment of CIVs. Thus, even if it appears that CIVs in each of the Contracting States would be entitled to benefits, it may be appropriate to confirm that position publicly (for example, through an exchange of notes) in order to provide certainty. It may also be appropriate to expressly provide for the treaty entitlement of CIVs by including, for example, a provision along the following lines:
>
> > Notwithstanding the other provisions of this Convention, a collective investment vehicle which is established in a Contracting State and which receives income arising in the other Contracting State shall be treated, for purposes of applying the Convention to such income, as an individual who is a resident of the Contracting State in which it is established and as the beneficial owner of the income it receives (provided that, if an individual who is a resident of the first-mentioned State had received the income in the same circumstances, such individual would have been considered to be the beneficial owner thereof). For purposes of this paragraph, the term "collective investment vehicle" means, in the case of [State A], a […] and, in the case of [State B], a […], as well as any other investment fund, arrangement or entity established in either Contracting State which

the competent authorities of the Contracting States agree to regard as a collective investment vehicle for purposes of this paragraph.

9.16 As discussed in paragraph 42 of the Commentary on Article 1 of the OECD Model Convention, Contracting States may consider that certain types of CIVs should not be allowed to claim treaty benefits in their own name but should rather be allowed to claim the treaty benefits to which the investors in these CIVs are entitled:

> 42. In some cases, the Contracting States might wish to take a different approach from that put forward in [*paragraphs 9.9, 9.14, 9.15 or 9.17*] with respect to certain types of CIVs and to treat the CIV as making claims on behalf of the investors rather than in its own name. This might be true, for example, if a large percentage of the owners of interests in the CIV as a whole, or of a class of interests in the CIV, are pension funds that are exempt from tax in the source country under terms of the relevant treaty similar to those described in paragraph 69 of the Commentary on Article 18. To ensure that the investors would not lose the benefit of the preferential rates to which they would have been entitled had they invested directly, the Contracting States might agree to a provision along the following lines with respect to such CIVs (although likely adopting [*one or more of the alternatives discussed in paragraphs 9.9, 9.14, 9.15 or 9.17]* with respect to other types of CIVs):
>
> *a*) A collective investment vehicle described in subparagraph *c*) which is established in a Contracting State and which receives income arising in the other Contracting State shall not be treated as a resident of the Contracting State in which it is established, but may claim, on behalf of the owners of the beneficial interests in the collective investment vehicle, the tax reductions, exemptions or other benefits that would have been available under this Convention to such owners had they received such income directly.
>
> *b*) A collective investment vehicle may not make a claim under subparagraph *a*) for benefits on behalf of any owner of the beneficial interests in such collective investment vehicle if the owner has itself made an individual claim for benefits with respect to income received by the collective investment vehicle.
>
> *c*) This paragraph shall apply with respect to, in the case of [State A], a [ ] and, in the case of [State B], a […], as well as any other investment fund, arrangement or entity established in either Contracting State to which the competent authorities of the Contracting States agree to apply this paragraph.
>
> This provision would, however, limit the CIV to making claims on behalf of residents of the same Contracting State in which the CIV is established. If […] the Contracting States deemed it desirable to allow the CIV to make claims on behalf of treaty-eligible residents of third States, that could be accomplished by replacing the words "this Convention" with "any Convention to which the other Contracting State is a party" in subparagraph *a*). If, as anticipated, the Contracting States would agree that the treatment provided in this paragraph would apply only to specific types of CIVs, it would be necessary to ensure that the types of CIVs listed in subparagraph *c*) did not include any of the types of CIVs listed in a more general provision such as that in [*one or more of the alternatives discussed in paragraphs 9.9, 9.14, 9.15 or 9.17]* so that the treatment of a specific type of CIV would be fixed, rather than elective. Countries wishing to allow individual CIVs to elect their treatment, either with respect to the CIV as a whole or with respect to one or more classes of interests in the CIV, are free to modify the paragraph to do so.

9.17 The practical application of the approach in the alternatives discussed in paragraphs 9.9 or 9.14 above requires a collective investment vehicle to determine the proportion of its investors who would have been entitled to benefits had they invested directly. This

raises practical difficulties, and requires administrative solutions, that are discussed in the following paragraphs of the Commentary on Article 1 of the OECD Model Convention:

> 43. Under either the approach *[in the alternatives discussed in paragraphs 9.9 or 9.14 above]*, it will be necessary for the CIV to make a determination regarding the proportion of holders of interests who would have been entitled to benefits had they invested directly. Because ownership of interests in CIVs changes regularly, and such interests frequently are held through intermediaries, the CIV and its managers often do not themselves know the names and treaty status of the beneficial owners of interests. It would be impractical for the CIV to collect such information from the relevant intermediaries on a daily basis. Accordingly, Contracting States should be willing to accept practical and reliable approaches that do not require such daily tracing.
>
> 44. For example, in many countries the CIV industry is largely domestic, with an overwhelming percentage of investors resident in the country in which the CIV is established. In some cases, tax rules discourage foreign investment by imposing a withholding tax on distributions, or securities laws may severely restrict offerings to non-residents. Governments should consider whether these or other circumstances provide adequate protection against investment by non-treaty-eligible residents of third countries. It may be appropriate, for example, to assume that a CIV is owned by residents of the State in which it is established if the CIV has limited distribution of its shares or units to the State in which the CIV is established or to other States that provide for similar benefits in their treaties with the source State.
>
> 45. In other cases, interests in the CIV are offered to investors in many countries. Although the identity of individual investors will change daily, the proportion of investors in the CIV that are treaty-entitled is likely to change relatively slowly. Accordingly, it would be a reasonable approach to require the CIV to collect from other intermediaries, on specified dates, information enabling the CIV to determine the proportion of investors that are treaty-entitled. This information could be required at the end of a calendar or fiscal year or, if market conditions suggest that turnover in ownership is high, it could be required more frequently, although no more often than the end of each calendar quarter. The CIV could then make a claim on the basis of an average of those amounts over an agreed-upon time period. In adopting such procedures, care would have to be taken in choosing the measurement dates to ensure that the CIV would have enough time to update the information that it provides to other payers so that the correct amount is withheld at the beginning of each relevant period.
>
> 46. An alternative approach would provide that a CIV that is publicly traded in the Contracting State in which it is established will be entitled to treaty benefits without regard to the residence of its investors. This provision has been justified on the basis that a publicly-traded CIV cannot be used effectively for treaty shopping because the shareholders or unitholders of such a CIV cannot individually exercise control over it. Such a provision could read:
>
> *a*) Notwithstanding the other provisions of this Convention, a collective investment vehicle which is established in a Contracting State and which receives income arising in the other Contracting State shall be treated for purposes of applying the Convention to such income as an individual who is a resident of the Contracting State in which it is established and as the beneficial owner of the income it receives (provided that, if an individual who is a resident of the first-mentioned State had received the income in the same circumstances, such individual would have been considered to be the beneficial owner thereof), if the principal class of shares or units in the collective investment vehicle is listed and regularly traded on a regulated stock exchange in that State.

b) For purposes of this paragraph, the term "collective investment vehicle" means, in the case of [State A], a […] and, in the case of [State B], a […], as well as any other investment fund, arrangement or entity established in either Contracting State which the competent authorities of the Contracting States agree to regard as a collective investment vehicle for purposes of this paragraph.

9.18 While the suggested provisions and explanations above apply to a Real Estate Investment Trust (REITs) that qualifies as a CIV, it is acknowledged that REITs do not always qualify as such and that they raise other specific treaty issues.

9.19 The Committee considers that the following part of the Commentary on Article 10 of the OECD Model Convention, which describes REITs and addresses issues that arise with the application of tax treaties to the distributions that REITs make, is relevant:

> 67.1 In many States, a large part of portfolio investment in immovable property is done through Real Estate Investment Trusts (REITs). A REIT may be loosely described as a widely held company, trust or contractual or fiduciary arrangement that derives its income primarily from long-term investment in immovable property, distributes most of that income annually and does not pay income tax on the income related to immovable property that is so distributed. The fact that the REIT vehicle does not pay tax on that income is the result of tax rules that provide for a single-level of taxation in the hands of the investors in the REIT.
>
> 67.2 The importance and the globalisation of investments in and through REITs have led the Committee on Fiscal Affairs to examine the tax treaty issues that arise from such investments. The results of that work appear in a report entitled "Tax Treaty Issues Related to REITS." [*reproduced in Volume II of the full version of the OECD Model Convention at R(23)-1*.]
>
> 67.3 One issue discussed in the report is the tax treaty treatment of cross-border distributions by a REIT. In the case of a small investor in a REIT, the investor has no control over the immovable property acquired by the REIT and no connection to that property. Notwithstanding the fact that the REIT itself will not pay tax on its distributed income, it may therefore be appropriate to consider that such an investor has not invested in immovable property but, rather, has simply invested in a company and should be treated as receiving a portfolio dividend. Such a treatment would also reflect the blended attributes of a REIT investment, which combines the attributes of both shares and bonds. In contrast, a larger investor in a REIT would have a more particular interest in the immovable property acquired by the REIT; for that investor, the investment in the REIT may be seen as a substitute for an investment in the underlying property of the REIT. In this situation, it would not seem appropriate to restrict the source taxation of the distribution from the REIT since the REIT itself will not pay tax on its income.
>
> 67.4 States that wish to achieve that result may agree bilaterally to replace paragraph 2 of the Article by the following:
>
> > 2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State (other than a beneficial owner of dividends paid by a company which is a REIT in which such person holds, directly or indirectly, capital that represents at least 10 per cent of the value of all the capital in that company), the tax so charged shall not exceed:
> >
> > *a*) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends (other than a paying company that is a REIT) throughout

a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);

b) 15 per cent of the gross amount of the dividends in all other cases.

According to this provision, a large investor in a REIT is an investor holding, directly or indirectly, capital that represents at least 10 per cent of the value of all the REIT's capital. States may, however, agree bilaterally to use a different threshold. Also, the provision applies to all distributions by a REIT; in the case of distributions of capital gains, however, the domestic law of some countries provides for a different threshold to differentiate between a large investor and a small investor entitled to taxation at the rate applicable to portfolio dividends and these countries may wish to amend the provision to preserve that distinction in their treaties. Finally, because it would be inappropriate to restrict the source taxation of a REIT distribution to a large investor, the drafting of subparagraph a) excludes dividends paid by a REIT from its application; thus, the subparagraph can never apply to such dividends, even if a company that did not hold capital representing 10 per cent or more of the value of the capital of a REIT held at least 25 per cent of its capital as computed in accordance with paragraph 15 above. The State of source will therefore be able to tax such distributions to large investors regardless of the restrictions in subparagraphs *a*) and *b*).

67.5 Where, however, the REITs established in one of the Contracting States do not qualify as companies that are residents of that Contracting State, the provision will need to be amended to ensure that it applies to distributions by such REITs.

67.6 For example, if the REIT is a company that does not qualify as a resident of the State, paragraphs 1 and 2 of the Article will need to be amended as follows to achieve that result:

1. Dividends paid by a company which is a resident, or a REIT organised under the laws, of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, dividends may also be taxed in, and according to the laws of, the Contracting State of which the company paying the dividends is a resident or, in the case of a REIT, under the laws of which it has been organised, but if the beneficial owner of the dividends is a resident of the other Contracting State (other than a beneficial owner of dividends paid by a company which is a REIT in which such person holds, directly or indirectly, capital that represents at least 10 per cent of the value of all the capital in that company), the tax so charged shall not exceed:

a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends (other than a paying company that is a REIT) throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);

b) 15 per cent of the gross amount of the dividends in all other cases.

67.7 Similarly, in order to achieve that result where the REIT is structured as a trust or as a contractual or fiduciary arrangement and does not qualify as a company, States may agree bilaterally to add to the alternative version of paragraph 2 set forth in paragraph 67.4 above an additional provision drafted along the following lines:

> For the purposes of this Convention, where a REIT organised under the laws of a Contracting State makes a distribution of income to a resident of the other Contracting State who is the beneficial owner of that distribution, the distribution of that income shall be treated as a dividend paid by a company resident of the first-mentioned State.
>
> Under this additional provision, the relevant distribution would be treated as a dividend and not, therefore, as another type of income (e.g. income from immovable property or capital gain) for the purposes of applying Article 10 and the other Articles of the Convention. Clearly, however, that would not change the characterisation of that distribution for purposes of domestic law so that domestic law treatment would not be affected except for the purposes of applying the limitations imposed by the relevant provisions of the Convention.

9.20 REITs also raise a specific issue with respect to the application of paragraph 4 of Article 13 to the alienation of interests that investors hold in these vehicles. The Committee considers that the following part of the Commentary on Article 13 of the OECD Model Convention, which explains this issue, is relevant:

> 28.10 Finally, a further possible exception [*to the application of paragraph 4 of Article 13*] relates to shares and comparable interests in a Real Estate Investment Trust (see paragraphs 67.1 to 67.7 of the Commentary on Article 10 for background information on REITs). Whilst it would not seem appropriate to make an exception to paragraph 4 in the case of the alienation of a large investor's interests in a REIT, which could be considered to be the alienation of a substitute for a direct investment in immovable property, an exception to paragraph 4 for the alienation of a small investor's interest in a REIT may be considered to be appropriate.
>
> 28.11 As discussed in paragraph 67.3 of the Commentary on Article 10, it may be appropriate to consider a small investor's interest in a REIT as a security rather than as an indirect holding in immovable property. In this regard, in practice it would be very difficult to administer the application of source taxation of gains on small interests in a widely held REIT. Moreover, since REITs, unlike other entities deriving their value primarily from immovable property, are required to distribute most of their profits, it is unlikely that there would be significant residual profits to which the capital gain tax would apply (as compared to other entities). States that share this view may agree bilaterally to add, before the phrase "may be taxed in that other State", words such as "except shares or comparable interests held by a person who holds, directly or indirectly, shares or interests representing less than 10 per cent of all the shares or interests in an entity if that entity is a REIT"
>
> 28.12 Some States, however, consider that paragraph 4 was intended to apply to any gain on the alienation of shares or similar interests in an entity that derives its value primarily from immovable property and that there would be no reason to distinguish between a REIT and a publicly held entity with respect to the application of that paragraph, especially since a REIT is not taxed on its income. These States consider that as long as there is no exception for the alienation of shares or similar interests in entities listed on a stock exchange (see paragraph 28.7 above), there should not be a special exception for interests in a REIT.

Commentary on Article 3

6. It is proposed to add the following new paragraphs to the Commentary on Article 3 of the UN Model in order to explain the addition of the new definition of "recognized pension fund" (the parts of the quoted Commentary on the OECD Model that appear in ~~strikethrough~~ would not be reproduced):

(g) The term "recognized pension fund"

12.1 The definition of "recognized pension fund" in subparagraph (*g*) was added in 2021. It broadly corresponds to the definition found in subparagraph (*i*) of the OECD Model Convention. The Committee considers that the following parts of the Commentary on Article 3 of the OECD Model Convention are applicable to the definition of "recognized pension fund" found in this Model (the changes or additional comments that appear in square brackets, which are not part of the Commentary on the OECD Model Convention, have been inserted in order to provide additional explanations or to reflect differences in the way certain issues are dealt with in this model and the OECD Model Convention):

> 10.3 The definition of the term "recognized pension fund" found in subparagraph [(*g*)] was included in [2021] when this term was added to paragraph 1 of Article 4 in order to ensure that a pension fund that meets the definition is considered as a resident of the Contracting State in which it is established.
>
> 10.4 The effect of the definition of "recognized pension fund" and of the reference to that term in paragraph 1 of Article 4 will depend to a large extent on the domestic law and on the legal characteristics of the pension funds established in each Contracting State as well as on the other provisions of the Convention where the definition might be relevant.
>
> 10.5 In some States, a fund might be established within a legal entity (such as a company engaged in commercial activities, an insurance company or the State itself, or a political subdivision or local authority thereof) for the main purpose of providing retirement benefits to individuals, such as the employees of that entity or of other employers, or of investing funds for the benefit of other recognized pension funds. Such a fund might not, however, constitute a separate "person" (as this term is defined in subparagraph a)) under the taxation laws of the State in which it is established and, if that is the case, it would not meet the definition of recognized pension fund. To the extent, however, that the income derived from the investment assets of that fund is attributed, under the domestic law of the State in which it is established, to the legal entity (e.g. company engaged in commercial activities, insurance company or State) within which the fund has been established, the provisions of the Convention will apply to that income to the extent that the legal entity itself qualifies as a resident of a Contracting State under paragraph 1 of Article 4. As explained in paragraphs 8.7 to 8.10 of the Commentary on Article 4, the inclusion of the term "recognized pension fund" in paragraph 1 of Article 4 is irrelevant for such a fund.
>
> 10.6 There are also some States where a fund established for the main purpose of providing retirement benefits to individuals does not formally constitute a separate person under the taxation laws of the State in which it is established but where these taxation laws provide that the investment assets of the fund constitute a separate and distinct patrimony the income of which is not allocated to any person for tax purposes. These States may want to ensure that their domestic law and the definition of "person" in subparagraph a) are broad enough to include such a fund in order to make sure that the Convention, which applies to persons that are residents of the Contracting States, is applicable to the income derived through these funds.
>
> 10.7 As indicated in paragraph 69 of the Commentary on Article 18 [as quoted in paragraph 18 of the Commentary on Article 18 of the UN Model], where two Contracting States follow the same approach of generally exempting from tax the investment income of pension funds established in their territory, these States may include in their convention a provision extending that exemption to the investment income that a pension fund established in one State derives from the other State. The definition of "recognized pension fund" might then be used for that purpose. If that is the case, however, it would be necessary to ensure

that a fund described in paragraph 10.5 above may qualify as a "recognized pension fund" in its own right notwithstanding the fact that it does not constitute a separate "person" under the taxation laws of the State in which it is established. Doing so, however, would require that, for the purposes of the Convention, the assets and income of such a fund are treated as the assets and income of a separate person so that, for example:

- the fund may constitute a person for the purposes of Article 1 and of all the relevant provisions of the Convention;
- the assets and income of the fund are considered those of a separate person and not those of the person within which the fund is established so that, for example, for the purposes of subparagraph a) of paragraph 2 of Article 10, any part of the capital of a company paying dividends to the fund that is held through the fund would not be aggregated with the capital of the same company that is held by the person within which the fund is established but that is not held through the fund;
- for the purposes of Articles 6 to 21, the income of the fund would be treated as derived, received and beneficially owned by the fund itself and not by the person within which the fund is established;
- the fund's entitlement to treaty benefits under the limitation on benefits provisions of Article 29 is determined without consideration of the entitlement to treaty benefits of the person within which the fund is established.

10.8 The following is an example of a provision that could be added to the definition of "recognized pension fund" for that purpose:

> Where an arrangement established in a Contracting State would constitute a recognized pension fund under subdivision (i) or (ii) if it were treated as a separate person under the taxation law of that State, it shall be considered, for the purposes of this Convention, as a separate person treated as such under the taxation law of that State and all the assets and income to which the arrangement applies shall be treated as assets held and income derived by that separate person and not by another person.

10.9 The first part of the definition of "recognized pension fund" refers to "an entity or arrangement established in that State". There is considerable diversity in the legal and organisational characteristics of pension funds around the world and it is therefore necessary to adopt a broad formulation. The reference to an "arrangement" is intended to cover, among other things, cases where pension benefits are provided through vehicles such as a trust which, under the relevant trust law, would not constitute an entity: the definition will apply as long as the trust or the body of trustees is treated, for tax purposes, as a separate entity recognized as a separate person. It is required, however, that the entity or arrangement be treated as a separate person under the taxation laws of the State in which it is established: if that is not the case, it is not necessary to deal with the issue of the residence of the pension fund itself as the income of that fund is treated as the income of another person for tax purposes (see paragraph 10.5 above).

10.10 Subdivision (i) provides that in order to qualify as a "recognized pension fund", an entity or arrangement must be established and operated exclusively or almost exclusively to administer or provide retirement and ancillary or incidental benefits to individuals. It does not matter how many individuals are entitled to such retirement benefits: a recognized pension fund may be set up, for instance, for a large group of employees or for a single self-employed individual. States are free to replace the phrase "retirement and ancillary or incidental benefits" by a different formulation, such as "retirement and similar benefits", as long as this formulation is interpreted broadly to include benefits such as death benefits.

10.11 The phrase "exclusively or almost exclusively" makes it clear that all or almost all the activities of a recognized pension fund must be related to the administration or the provision of retirement benefits and ancillary or incidental benefits to individuals. The words "almost exclusively" recognise that a very small part of the activities of a pension fund might involve activities that are not strictly related to administration or provision of such benefits (e.g. such as marketing the services of the pension fund). Some states, however, have a broader view of the term "recognized pension fund" and may want, for example, to cover entities or arrangements established and operated exclusively or almost exclusively to provide pensions and benefits, such as disability pensions, that are not related to retirement. These states are free to amend the definition so as to adapt it to their circumstances. In doing so, however, these States should take account of the fact that, as noted in paragraph 10.7 above, the definition of recognized pension fund may be used for the purposes of provisions exempting from source taxation the investment income that a pension fund established in one State derives from the other State; it will therefore be important for these States to ensure that the scope of that exemption is not inadvertently extended by changes made to the definition of "recognized pension funds".

10.12 The entity or arrangement must be established and operated exclusively or almost exclusively for the purpose of administering or providing retirement benefits and ancillary or incidental benefits to individuals. A pension paid upon retirement from active employment or when an employee reaches retirement age would be the typical example of a "retirement benefit" but this term is broad enough to cover one or more payments made at or after retirement, or upon reaching retirement age, to an employee, a self-employed person or a director or officer of a company, even if these payments are not made in the form of regular pension payments.

10.13 In many States, pension funds provide a number of benefits that are not strictly linked to retirement and the phrase "ancillary or incidental benefits" is intended to cover such benefits. The words "ancillary or incidental" make it clear that such benefits are provided in addition to retirement benefits: a fund that would be set up primarily in order to provide benefits that are not retirement benefits would therefore not meet the definition. Whilst it would be impossible to provide an exhaustive list of all benefits that would qualify as "ancillary or incidental benefits", the following are typical examples of such benefits:

- payments made as a result of the death or disability of an individual;
- pension or other types of payments made to surviving members of the family of a deceased individual who was entitled to retirement benefits;
- payments made to an individual suffering from a terminal illness;
- income substitution payments made in the case of long-term sickness or unemployment;
- housing benefits, such as a loan at a preferential rate granted from accumulated pension contributions to a pension contributor for the acquisition of a principal residence;
- education benefits, such as the withdrawal of accumulated pension contributions that a pension contributor would be allowed to make for the purpose of financing her education or that of her children;
- the provision of financial advice to pension contributors.

10.14 Subdivision (i) also requires that the entity or arrangement established and operated exclusively or almost exclusively to administer or provide retirement and ancillary or incidental benefits to individuals be "regulated as such". The requirement is intended to restrict the definition to entities or arrangements that are subject to some conditions imposed

by the State where it is established (or one of its political subdivisions or local authorities) in order to ensure that the entity or arrangement is used as a vehicle for investment in order to provide retirement and ancillary or incidental benefits to individuals. That part of the definition would therefore exclude an entity, such as a private company, that might be set up and used by a person to invest funds in order to provide retirement benefits to persons related to, or employed by, that person but that would not be subject to any special treatment or to rules imposed by the State, political subdivision or local authority concerning the use of that entity as a vehicle to provide retirement benefits. It does not matter whether the regulatory framework to which the entity or arrangement is subjected is provided in tax laws or in other legal instruments (e.g. the legislation that establishes a State-owned entity that will operate a public pension fund); what matters is that the entity or arrangement be recognized by law as a vehicle established to finance retirement benefits for individuals and be subject to conditions intended to ensure that it is used for that purpose.

10.15 An example of an entity or arrangement that would satisfy the requirements of the definition of "recognized pension fund" is an agency or instrumentality of a State set up exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits under the social security legislation of that State. Another example would be a company or other entity that is established in a State for the purpose of administering or providing retirement benefits and ancillary or incidental benefits to individuals and whose only assets include funds that are covered by a retirement scheme regulated by the tax laws of that State which provide that the income from that scheme is exempt from tax. The definition of recognized pension fund would apply to that company or entity regardless of whether that company or entity otherwise qualifies as a resident of a Contracting State because it is "liable to tax therein" by reason of the criteria mentioned in the first sentence of paragraph 1 of Article 4, e.g. because it must pay tax on any income not derived from the scheme (see paragraphs 8.8 to 8.10 of the Commentary on Article 4).

[…]

10.17 Subparagraph (ii) of the definition covers entities or arrangements that pension funds covered by subparagraph (i) use to invest indirectly. Pension funds often invest together with other pension funds pooling their assets in certain entities or arrangements and may, for various commercial, legal or regulatory reasons, invest via wholly owned entities or arrangements that are residents of the same State. Since such arrangements and entities act only as intermediaries for the investment of funds used to provide retirement benefits to individuals, it is appropriate to treat them like the pension funds that invest through them.

10.18 The phrase "exclusively or almost exclusively" found in subparagraph (ii) makes it clear that all or almost all of the activities of such an intermediary entity or arrangement must be related to the investment of funds for the benefit of entities or arrangements that qualify as recognized pension funds under subparagraph (i). The words "almost exclusively" recognise that a very small part of the activities of such entities or arrangements might involve other activities, such as the investment of funds for pension funds that are established in other States and, for that reason, are not covered by subparagraph (i). […]

12.2 As noted in paragraph 10.16 of the OECD Commentary on Article 3, "[s]ubdivision (i) of the definition applies regardless of whether the benefits to which it refers are provided to individuals who are residents of the State in which the entity or arrangement is established or are residents of other States." As indicated in paragraph 41 of the Commentary on Article 29 of the OECD Model Convention, "some States […] consider that the risk of treaty shopping by recognized pension funds does not warrant the costs of compliance inherent in requiring funds to identify the treaty residence and entitlement of the individuals entitled to receive pension benefits."

12.3 Other States, however, may prefer to restrict the scope of the definition instead of relying solely on the general anti-abuse rule in paragraph 9 of Article 29 to address possible treaty-shopping concerns related to the definition of "recognized pension fund". This may be done by adopting the following alternative version of the definition:

(*g*) the term "recognized pension fund" of a State means an entity or arrangement established in that State that is treated as a separate person under the taxation laws of that State and:

(i) that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities provided that more than 50 per cent of the beneficial interests in that entity or arrangement are owned by individuals resident of either Contracting State, or more than [__ per cent] of the beneficial interests in that person are owned by individuals resident of either Contracting State or of any other State with respect to which the following conditions are met

(A) individuals who are residents of that other State are entitled to the benefits of a comprehensive convention for the avoidance of double taxation between that other State and the State from which the benefits of this Convention are claimed, and

(B) with respect to income referred to in Articles 10 and 11 of this Convention, if the person were a resident of that other State entitled to all the benefits of that other convention, the person would be entitled, under such convention, to a rate of tax with respect to the particular class of income for which benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention; or

(ii) that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements to which subdivision (i) applies.

12.4 Subdivision (i) of this alternative definition only applies if more than 50 per cent of the beneficial interests in the entity or arrangement are owned by individuals resident of either Contracting State. Taking into account the fact that, in some countries, it is common for pension funds to cover residents of other countries, the scope of the definition is extended to cover individuals who, although non-residents of either Contracting State, meet certain conditions. In that case the definition also applies as long as a certain percentage (to be determined through bilateral negotiations) of the beneficial interests in the entity or arrangement are held by individuals resident of either Contracting State or by residents of third states who meet the following two conditions: first, these individuals are entitled to the benefits of a comprehensive tax convention concluded between that third State and the State of source and, second, that convention provides for a similar or greater reduction of source taxes on interest and dividends derived by pension funds of that third State. For the purposes of subdivision (i) of this alternative, the term "beneficial interests in that person" should be understood to refer to the interests held by persons entitled to receive pension benefits from the entity or arrangement.

Proposed minority view

12.5 [One Member of the Committee] [*that wording might need to be amended based on the number of members who would support that view and of any decisions*

concerning minority views that may be reached by the Committee under item 3(a) of its agenda] did not agree with the inclusion of a definition of "recognized pension fund" in Article 3. Th[at member] considered that this definition was intended to address the situation of pension funds which formally constitute separate persons under the domestic law of a State but, in th[at member's] view, pension funds would not be considered separate persons in most countries. For th[at member], there was not enough justification to make this change.

Commentary on Article 4

7. It is proposed to amend paragraphs 6 to 6.2 of the Commentary on Article 4 of the UN Model in order to take account of the addition of the reference to a "recognized pension fund" in paragraph 1 of Article 4 (changes appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

6. ~~The OECD Commentary observes:~~***Paragraph 1 was modified in 1999 to clarify that the definition of "resident of a Contracting State" applied to the State itself as well as to any of its political subdivisions or local authorities. Similarly, in 2021, the reference to a "recognized pension fund" was added to the definition of "resident of a Contracting State" in paragraph 1. This corresponded to a similar addition made to the OECD Model Convention in 2017 and was intended to clarify how tax treaties apply to investments made by pension funds. In this respect, the Committee considers that the following parts of the Commentary on Article 4 of the OECD Model Convention are applicable with respect to paragraph 1 of Article 4 of the UN Model:***

8.4 It has been the general understanding of most member countries that the government of each State, as well as any political subdivision or local authority thereof, is a resident of that State for purposes of the Convention. Before 1995, the Model did not explicitly state this; in 1995, Article 4 was amended to conform the text of the Model to this understanding.

~~(It may be mentioned that in 1999, the United Nations Model Convention also adopted the same amendment.)~~

~~8.6 Paragraph 1 refers to persons who are "liable to tax" in a Contracting State under its laws by reason of various criteria. In many States, a person is considered liable to comprehensive taxation even if the Contracting State does not in fact impose tax. For example, 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 (see, for example, paragraph 1 of Article 10 and paragraph 5 of Article 11).~~

~~8.7 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.~~

~~8.8 Where a State disregards a partnership for tax purposes and treats it as fiscally transparent, taxing the partners on their share of the partnership income, the partnership itself is not liable to tax and may not, therefore, be considered to be a resident of that State. In such a case, since the income of the partnership "flows through" to the partners under the domestic law of that State, the partners are the persons who are liable to tax on that income and are thus the appropriate persons to claim the benefits of the conventions concluded by the States of which they are residents. This latter result will be achieved even if, under the domestic law of the State of source, the income is attributed to a partnership which is treated as a separate taxable entity. For States which could not agree with this interpretation of the Article, it would be possible to provide for this result in a special provision which would avoid the resulting potential double taxation where the income of the partnership is differently allocated by the two States.~~

8.6 Paragraph 1 also refers expressly to a "recognized pension fund". 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. Until 2017, that view was reflected in the previous version of paragraph 8.11, which referred to "pension funds, charities and other organisations" as entities that most States viewed as residents. Paragraph 1 of the Article was modified in 2017 to remove any doubt about the fact that a pension fund that meets the definition of "recognized pension fund" in paragraph 1 of Article 3 constitutes a resident of the Contracting State in which it is established.

8.7 As indicated in paragraph 10.4 of the Commentary on Article 3, the effect of the definition of "recognized pension fund" and of the reference to that term in paragraph 1 of the Article will depend to a large extent on the domestic law and on the legal characteristics of the pension funds established in each Contracting State. The type of fund established within a legal entity that is described in paragraph 10.5 of the Commentary on Article 3 would not be covered by the definition of "recognized pension fund", which applies to an entity or arrangement that constitutes a separate person, but since the income of these funds is attributed to the legal entity of which it is part, the provisions of the Convention will apply to that income to the extent that the legal entity itself qualifies as a resident of a Contracting State under paragraph 1 of the Article.

8.8 Where, however, a fund constitutes a "person" which is distinct from any other person by whom, or for the benefit of whom, it has been established and is operated, the definition of "recognized pension fund" will be relevant and, to the extent that the conditions of that definition are met, the fund will itself constitute a "resident of a Contracting State". This will be the case in many countries because it is "liable to tax therein" by reason of the criteria mentioned in the first sentence of paragraph 1, as this sentence is interpreted by the Contracting States or, if that is not the case, because of the specific inclusion of the term "recognized pension fund" in paragraph 1.

8.9 Contracting States are of course free to omit the reference to "recognized pension funds" in paragraph 1 if they conclude that the income of the pension arrangements established in both States is derived by persons that otherwise qualify as residents of the Contracting States, although they might prefer to keep that reference in the paragraph simply to remove any uncertainty.

8.10 Given the diversity of arrangements through which retirement benefits are provided, it will therefore often be useful for the Contracting States to review the main types of pension arrangements used in each State and to clarify whether or not the definition of "recognized pension fund" applies to each type of arrangement and, more generally, how the provisions of the tax convention between these States apply to these

arrangements. This could be done at the time of the negotiation of that convention or subsequently through the mutual agreement procedure.

8.11 Paragraph 1 refers to persons who are "liable to tax" in a Contracting State under its laws by reason of various criteria. In many States, a person is considered liable to comprehensive taxation even if the Contracting State does not in fact impose tax. For example, 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 (see, for example, paragraph 1 of Article 10 and paragraph 5 of Article 11).

8.12 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.

8.13 Where a State disregards a partnership for tax purposes and treats it as fiscally transparent, taxing the partners on their share of the partnership income, the partnership itself is not liable to tax and may not, therefore, be considered to be a resident of that State. In that case, however, paragraph 2 of Article 1 clarifies that the Convention will apply to the partnership's income to the extent that the income is treated, for purposes of taxation by that State, as the income of a partner who is a resident of that State. The same treatment will apply to income of other entities or arrangements that are treated as fiscally transparent under the tax law of a Contracting State (see paragraphs 2 to 16 of the Commentary on Article 1).

6.1 Some countries ~~wish~~ ***may prefer to abstain from addressing the issue of the residence of pension funds in their Conventions***~~wish to clarify that recognized pension funds will be treated under Article 4 as residents of the Contracting State in which they are established~~. These countries could amend paragraph 1 of Article 4 by ~~adding~~***deleting the*** reference to recognized pension funds ***and omit the definition of "recognized pension fund" in Article 3. In such a case, however, there could be risks that pension funds would not be entitled to treaty benefits if they did not otherwise qualify as "residents of a Contracting State".***

Proposed minority view

6.2 [One Member of the Committee] [*that wording might need to be amended based on the number of members who would support that view and of any decisions concerning minority views that may be reached by the Committee under item 3(a) of its agenda*] did not agree with the inclusion of a reference to a "recognized pension fund" in paragraph 1 of Article 4 and with the inclusion of a definition of "recognized pension fund" in Article 3. For th[at member], deeming a recognised pension fund to be a "resident" regardless of the necessity of being liable to tax did not appear to be acceptable technically. According to th[at member], while the OECD Commentary indicates 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" (see quoted paragraph 8.6), this does not seem to be case with most member countries of the UN.

6.2 ***As regards paragraph 8.13 of the OECD Commentary quoted above, s***ome members of the Committee of Experts ~~disagree with the proposition~~ ***~~expressed in~~*** ~~paragraph 8.8 of the 2014 OECD Commentary extracted above~~ ***consider*** that the partners of fiscally transparent partnerships can***not*** claim the benefits of the Convention ***in the absence of a rule such as paragraph 2 of Article 1***. They are of the view that a special rule is ***indeed*** required in a Convention to provide such a result. ~~This is achieved, for instance, by adopting the new paragraph 2 of Article 1 that is now included in the Convention.~~ Paragraph 2 of Article 1 clarifies that the Convention will apply to the partnership's income to the extent that the income is treated, for purposes of taxation by that State, as the income of a partner who is a resident of that State. The same treatment will apply to income of other entities or arrangements that are treated as fiscally transparent under the tax law of a Contracting State.

Commentary on Article 10

8. It is proposed to add the following new paragraph 13.3 immediately after existing paragraph 13.2 of the Commentary on Article 10 in order to provide a cross-reference to the new part of the Commentary on Article 1 that deals with the application of Art. 10(2) to distributions of dividends by a REIT:

13.3 The application of paragraph 2 to distributions made by a Real Estate Investment Trust (REIT) raises policy issues which are discussed in paragraph 9.19 of the Commentary on Article 1.

Commentary on Article 13

9. It is proposed to add the following new paragraph 8.5 immediately after existing paragraph 8.4 of the Commentary on Article 13 in order to provide a cross-reference to the new part of the Commentary on Article 1 that deals with the application of Art. 13(4) to the alienation of shares or comparable interests in a REIT:

8.5 The application of paragraph 4 to the alienation of shares and comparable interests in a Real Estate Investment Trust (REIT) raises policy issues which are discussed in paragraph 9.20 of the Commentary on Article 1.

Commentary on Article 29

10. It is proposed to make the following consequential changes to the Commentary on Article 29 in order to reflect the fact that the anti-treaty shopping rules applicable to a "recognized pension fund" should normally be part of the new definition of that term (the proposed changes appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

13. Paragraphs 39 and 40 of the Commentary on the detailed version of Article 29 ~~of the detailed version~~ of the OECD Model Convention provide (the changes or additional comments that appear in square brackets, which are not part of the Commentary on the OECD Model Convention,

have been inserted in order to provide additional explanations or to reflect the differences between the OECD and UN models):

> 39. Subparagraph *e*) of the detailed version provides rules under which certain non-profit organisations (to the extent that they qualify as residents of a Contracting State, as explained in paragraph ***8.11*** ~~[8.6 and 8.7]~~ of the ~~[2014]~~ Commentary on Article 4) and ***[…]***~~certain~~ recognized pension funds ***[as defined in subparagraph 1(g) of Article 3]*** will be entitled to all the benefits of the Convention.
>
> 40. Entities that would be described in subdivision (i) automatically qualify for treaty benefits without regard to the residence of their beneficiaries or members. These entities would generally correspond to those that do not pay tax in their State of residence and that are constituted and operated exclusively to fulfil certain social functions (e.g. charitable, scientific, artistic, cultural, or educational). The description of such entities that will be included in subdivision (i) with respect to each State will typically refer to the provisions of the domestic law of that State that describe these entities or to the domestic law factors that allow the identification of these entities. Depending on the wording used, States may also want to amend subdivision (i) in order to allow their competent authorities to agree subsequently to amend or supplement the description provided.

13.1 The reference, in subdivision (*ii*), to "recognized pension funds as defined in subparagraph 1(*g*) of Article 3" ensures that these pension funds will be entitled to the benefits of the Convention regardless of whether the beneficial interest in such funds are held by individuals who are residents of the State in which they are established or are residents of other States. As indicated in paragraph 12.3 of the Commentary on Article 3, however, some States may prefer to restrict the definition of recognized pension fund to address possible treaty-shopping concerns arising from that aspect of the definition. This would be done by adopting the alternative formulation of the definition found in that paragraph of the Commentary on Article 3.

14. Not all States, however, include ***the definition of recognized pension fund*** ~~with~~in the scope of their tax conventions ~~recognized pension funds~~. ~~Those~~ States ***that do not include that definition may wish to amend Article 29 so as to ensure that if a pension fund otherwise qualifies as a resident of a Contracting State, it will constitute a "qualified person" if it satisfies the conditions provided for in the alternative definition in paragraph 12.3 of the Commentary on Article 3 as regards the holding of beneficial interests in the pension fund by persons who are either residents of a Contracting State or, possibly, equivalent beneficiaries.*** ~~should, in their drafting of Article 29, therefore delete clauses (ii) and (iii) of subparagraph e). However, States that wish to clarify the application of a tax convention to recognized pension funds may wish to define the term "recognized pension fund" in Article 3. Such definition could be drafted along the following lines and included as a subparagraph to paragraph 1 of that Article:~~

> ~~"the term "recognized pension fund" of a State means an entity or arrangement established in that State that is treated as a separate person under the taxation laws of that State and:~~
>
> ~~(i) that is established an operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities; or~~
>
> ~~(ii) that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in subdivision (i)."~~

~~States that under their domestic law do not recognize a pension fund as a person could replace the opening clause of the definition above with the following:~~

> ~~"the term "recognized pension fund" of a State means an entity or arrangement established in that State under the laws of that State and:"~~

~~Such States should also make sure that the definition of "resident" in paragraph 1 of Article 4 includes such an entity or arrangement (see paragraph 7 of the Commentary to paragraph 1 of Article 4).~~

~~15. Paragraphs 41 and 42 of the Commentary to the detailed version of Article 29 of the OECD Model provide:~~

> ~~"41. Under subdivision (ii), a recognized pension fund that falls within subdivision (i) of the definition of that term in paragraph 1 of Article 3 (which is the part of the definition that applies to an entity that administers or provides retirement benefits and ancillary or incidental benefits to individuals) will qualify for treaty benefits if more than 50 per cent of the beneficial interests in that person are owned by individuals resident of either Contracting State or if more than a certain percentage of these beneficial interests, to be determined during bilateral negotiations, are owned by such residents or by individuals who are residents of third States provided that, in the latter case, two additional conditions are met: first, these individuals are entitled to the benefits of a comprehensive tax convention concluded between that third State and the State of source and, second, that convention provides for a similar or greater reduction of source taxes on interest and dividends derived by pension funds of that third State. For purposes of this provision, the term "beneficial interests in that person" should be understood to refer to the interests held by persons entitled to receive pension benefits from the fund. Some States, however, consider that the risk of treaty shopping by recognized pension funds does not warrant the costs of compliance inherent in requiring funds to identify the treaty residence and entitlement of the individuals entitled to receive pension benefits. States that share that view may modify subdivisions (ii) and (iii) accordingly and may, for instance, simply replace these two subdivisions by one subdivision that would read "is a recognized pension fund", which, like the provision found in the simplified version, would ensure that any recognized pension fund covered by the definition found in paragraph 1 of Article 3 would automatically constitute a "qualified person".~~
>
> ~~42. Subdivision (iii) applies to the so-called "funds of funds" that are referred to in subdivision (ii) of the definition of "recognized pension fund" in paragraph 1 of Article 3. These are funds which do not directly provide retirement benefits to individuals but are constituted and operated to invest funds of recognized pension funds that are themselves covered by subdivision (i) of the definition of "recognized pension fund". Subdivision (iii) only applies, however, if substantially all the income of such a "fund of funds" is derived from investments made for the benefit of recognized pension funds qualifying for benefits under subdivision (ii)."~~

11. It is proposed to make the following consequential changes to paragraph 17 of the Commentary on Article 29 in order to reflect the fact that the anti-treaty shopping rules applicable to CIVs should be incorporated in any specific provision concerning the application of the Convention to CIVs that would appear in paragraph 4 of Article 1 (the proposed changes appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

> 17. ***Collective investment vehicles that would be covered by specific provisions included in paragraph 4 of Article 1 (see the section on "Collective Investment" in the***

Commentary on Article 1) would logically be included in the definition of "qualified person" because any treaty shopping concerns related to residents of third states investing in such vehicles should be dealt through the drafting of such provisions (as explained in paragraphs 9.8 to 9.17 of the Commentary on Article 1). ~~Countries wishing to provide a rule addressing the entitlement to benefits of "collective investment vehicles" could include such a rule as subparagraph g) of paragraph 2. The inclusion of such a rule could be a useful tool to facilitate foreign portfolio investment, although in drafting any such rule, countries should aim not to create opportunities for treaty shopping through the use of collective investment vehicles.~~

ANNEX

Comments from Rajat Bansal and comments received on the discussion draft

1. Comments by Rajat Bansal (sent before the 20th session)

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.

2. Comments received on the discussion draft

12. The following are the comments that were received on the discussion draft:

COLLECTIVE INVESTMENT VEHICLE (CIV[2]) INDUSTRY ASSOCIATIONS

The collective investment vehicle (CIV[3]) industry associations signing this letter[4] support strongly the CIV-specific provisions contained in the discussion draft entitled "Proposed Changes to the United Nations Model Double Tax Convention Between Developed and Developing Countries Concerning the Tax Treaty Treatment of Collective Investment Vehicles, Pension Funds, and REITs." This discussion draft's proposed changes to the Commentary on the UN Model identify

2 We use the term "CIV" as it is used in proposed paragraph 9.3 of the proposed Commentary on Article 1 of the UN Model. Specifically, we use the term "CIV" to refer only to funds that are widely-held, hold a diversified portfolio of securities, and are subject to investor-protection regulation in the country in which they are established.

3 We use the term "CIV" as it is used in proposed paragraph 9.3 of the proposed Commentary on Article 1 of the UN Model. Specifically, we use the term "CIV" to refer only to funds that are widely-held, hold a diversified portfolio of securities, and are subject to investor-protection regulation in the country in which they are established.

4 These organizations, as listed at the end of this letter, are: Association of the Luxembourg Fund Industry; Assogestioni; BVI Bundesverband Investment und Asset Management; EFAMA - European Fund and Asset Management Association; Financial Services Council (Australia); Hong Kong Investment Funds Association; ICI Global; The Investment Association; The Investment Funds Institute of Canada; and Irish Funds Industry Association.

key issues for treaty negotiators and provide appropriate alternative methods for providing CIVs with treaty relief.

CIVs, as explained in the April 2019 CIV industry association coalition letter (attached), have a paramount need for treaty eligibility certainty and administrable rules for receiving treaty benefits to which they or their investors are entitled. Many important benefits are provided by CIVs to investors[5] and to developing countries.[6]

The guidance provided by the draft proposed changes to the Commentary, when incorporated into tax treaties or by memoranda of understanding (MOUs), will provide CIVs with the requisite certainty. The enhanced investment returns provided by this certainty (benefiting investors) will increase the ability to attract capital for economic growth (benefiting governments and their taxpayers). Lower treaty relief administrative costs likewise will benefit CIV investors, governments, and taxpayers.

From the CIV industry's perspective, it is imperative that CIVs be able to claim treaty relief either directly (when the CIV meets all legal requirements) or indirectly on behalf of treaty-eligible investors. Individual investors, as explained in our April 2019 submission, have neither the necessary information nor the individual financial incentive to incur the costs involved in pursuing treaty claims with respect to their CIVs' investments.

We are pleased that the draft Commentary provides mechanisms—which will vary based upon differences in how the CIVs are organized and operated (as a legal matter) and distributed (as a practical matter)—by which all CIVs can claim treaty relief either directly or on behalf of their investors. As the Commentary effectively notes, there simply is not a "one size fits all" solution.

Some CIVs (including both domestically and globally distributed CIVs), we submit, meet every applicable requirement to receive treaty relief in their own right. Paragraph 9.15 of the proposed Commentary provides this treatment. For CIVs that do not meet these requirements, we submit, full treaty entitlement also should be provided when a substantial portion of the investors are treaty entitled. This treatment is provided by paragraph 9.14.

CIVs that cannot claim full treaty relief nevertheless must be given the opportunity to claim treaty relief to the extent of their eligible investors (including, we submit, those who are equivalent beneficiaries). Paragraph 9.9 of the proposed Commentary achieves this result.

Finally, if a large percentage of the owners of a CIV, or a class of CIV interests, are held by pension funds, it is appropriate to look through the CIV and provide relief based upon the treaty eligibility status of the pension fund investors. This treatment, provided by paragraph 9.16, will ensure that pension fund investors (such as those exempt from withholding tax) receive the full benefit negotiated by their treaty negotiators.

For those CIVs for which treaty-eligibility determinations are made at the individual investor level (in paragraphs 9.9 and 9.14), it is essential that practical and reliable approaches be provided for making these determinations. Consequently, we also fully support the approaches provided in paragraph 9.17. Without practical and reliable approaches for ensuring appropriate treaty relief,

5 Individuals investing in CIVs receive an interest in a diversified portfolio of securities that is professionally managed at reasonable cost. The highly-regulated nature of CIVs make them sound investment vehicles for middle-class investors.

6 These benefits include access to capital from portfolio ("non-controlling") investors. Moreover, as explained in the 2018 paper prepared for your consideration by members of your Subcommittee, engaging in portfolio-type investments "considerably reduces the risk of BEPS." E/C.18/2018/CRP.10, dated 2 October 2018.

the cross-border CIV investment incentive intended by the treaty negotiators will not materialize. This unfortunate result would be particularly problematic for developing countries seeking capital from portfolio "non-controlling" investors.

Conclusion

The undersigned CIV industry associations support strongly the CIV-specific mechanisms contained in the discussion draft for claiming treaty relief. Equally important to the various alternative methods by which treaty eligibility may be determined is the Commentary's support, which we appreciate, for practical and reliable approaches for investor tax residency determinations. Finally, we encourage tax administrations to develop MOUs to provide CIV treaty eligibility clarification until certainty can be provided in a new or amended tax convention.

* * *

Please feel free to contact the representatives at the associations signing this letter, at your convenience, if we can provide you with any additional information.

Sincerely,

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[Attachment (12 April 2019 letter)]

Ms. Carmel Peters, Coordinator
UN Model Tax Convention Subcommittee
United Nations Headquarters
405 East 42nd Street
New York, NY, 10017

RE: Strong Industry Support for UN Guidance on CIV Tax Treaty Eligibility

Dear Ms. Peters,

The collective investment vehicle (CIV) industry associations signing this letter[7] are writing to encourage the United Nations' Committee of Experts on International Cooperation in Tax Matters to develop CIV-specific Commentary for the UN Model Income Tax Convention. Specifically, we urge the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries to support this work when item 3(b)(ii) of the provisional agenda for the Committee's eighteenth session is discussed on 25 April 2019.

The paper that was prepared by Committee member Christoph Schelling and his colleagues for the Subcommittee's consideration during its October 2018 meeting (hereafter "the 2018 paper")[8] clearly identifies the need for guidance specific to CIVs[9] and key issues that must be addressed.

7 These organizations, as listed at the end of this letter, are: Association of the Luxembourg Fund Industry; Assogestioni; BVI Bundesverband Investment und Asset Management; EFAMA - European Fund and Asset Management Association; Financial Services Council (Australia); Hong Kong Investment Funds Association; ICI Global; The Investment Association; The Investment Funds Institute of Canada; Irish Funds Industry Association; and Swiss Funds & Asset Management Association SFAMA.

8 E/C.18/2018/CRP.10, dated 2 October 2018, and found at: https://www.un.org/esa/ffd/wp-content/uploads/2018/08/CRP10-Taxation-of-Collective-Investment-Vehicles-CIVs.pdf

9 We use the term "CIV" as it was used in the 2018 paper and by the Organisation for Economic Co-Operation and Development (OECD) in its 2010 Report on "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" (the "CIV Report"). http://www.oecd.org/dataoecd/59/7/45359261.pdf. Specifically, we use the term "CIV" to refer only to funds that are widely-held, hold a diversified portfolio of securities, and are subject to investor-protection regulation in the country in which they are established.

The paper also explains the many benefits that CIVs provide to investors10 and to developing countries.[11] We wholeheartedly agree with these observations.

This letter supplements the excellent 2018 paper by providing the CIV industry perspective. We also would be pleased to provide supporting technical assistance should the Subcommittee agree to move forward with this guidance project.[12]

CIVs, as explained below, have a paramount need for treaty eligibility certainty and administrable rules for receiving treaty benefits to which they or their investors are entitled. Tax certainty and administrable rules benefit both CIV investors and governments. Enhanced investment returns (benefiting CIV investors saving for long-term needs such as retirement) increase the ability to attract capital for economic growth (benefiting governments and their taxpayers). Lower treaty relief administrative costs likewise benefit CIV investors, governments, and taxpayers.

The CIV Industry's Economic Importance

The CIV industry is economically important, as noted in the 2018 paper, because CIVs provide capital for economic growth and an effective way for middle-class investors to save for long-term needs such as retirement. The worldwide assets of "open-end" CIVs[13], at the end of 2018, totaled US$46.7 trillion.[14] CIVs invest in both the equity and debt securities of operating enterprises and the public debt of both developed and developing countries. These "portfolio" investments, which are not made to gain control of an operating company, help fuel global economic growth.

Background—CIVs in General

CIVs are widely held. The typical CIV will have many thousands (often tens or hundreds of thousands) of investors.

The proportionate interest of any one investor in a CIV generally will be de minimis. For those CIVs that are "open-end," moreover, each investor's proportionate interest in the CIV's assets typically will change every day. Because interests in these CIV may be purchased from or sold to the CIV every day, the number of CIV interests outstanding changes every day. So, even if an investor does not buy or sell CIV interests on any given day, others generally will; these other transactions will change every investor's proportionate interest in the CIV.

Important differences exist in how different CIVs' interests are distributed. First, CIVs may be distributed locally, regionally, or globally. Second, investors may buy or sell CIV interests either directly from the CIV sponsor or, more likely, from an affiliated or unaffiliated distributor or even from a fund platform. These differences, and others, help explain why the 2018 paper discusses

10 Individuals investing in CIVs receive an interest in a diversified portfolio of securities that is professionally managed at reasonable cost. The highly-regulated nature of CIVs make them sound investment vehicles for middle-class investors.

11 These benefits include access to capital from portfolio ("non-controlling") investors. As the 2018 paper notes, engaging in portfolio-type investments "considerably reduces the risk of BEPS."

12 Some associations signing this letter also are prepared to provide assistance should the Subcommittee also consider treaty entitlement issues for widely held regulated investment vehicles that hold assets other than a diversified portfolio of securities (and hence are not within the generally agreed definition of CIV).

13 Interests in these CIVs generally can be purchased every day at "net asset value" from the CIV manager—rather than on a stock exchange. These CIVs are known by names such as "mutual funds" and "UCITS" (or Undertakings for Collective Investments in Transferable Securities).

14 See https://www.ici.org/research/stats/worldwide/ww_q4_18.

various alternative approaches for ensuring that all CIVs have some mechanism for claiming appropriate treaty relief.

CIVs have different distribution targets. Many CIVs are registered for sale, and distributed, only in the country in which they are organized; these CIVs generally have essentially 100 percent "home-country" investors. Other CIVs are offered either regionally (such as throughout Europe) or globally. Distributors, regardless of whether CIVs are for local, regional, or global investors, typically will have a local clientele. Specifically, even when CIVs may have regional or global distribution networks, the distributors that operate within each separate country typically have a local clientele.

CIV units that are acquired through affiliated and unaffiliated distributors often are held in a nominee (or "street name") account in the name of the distributor, rather than in the investors' names. Consequently, the CIV may not know the identity of the underlying owners. This lack of transparency to the CIV occurs, as noted in the 2018 paper, because the individual investor's identity is proprietary information belonging to the distributor.

Nevertheless, the identity and tax residence of each CIV investor is known. Most specifically, the distributor knows the tax residency of its clients (as required by know-your-customer due diligence requirements and related tax reporting obligations). The extent to which CIVs receive this information automatically, or can receive it periodically, is very fact specific and depends on numerous factors. Nevertheless, CIVs generally have indications of the underlying owners' tax residency because of the nature of the distributor through which the investment was made.

Although a CIV's investor base typically changes every day, the tax residencies of the CIV's investors is unlikely to change significantly—except perhaps over an extended period. Even in the case of a globally-distributed CIV, where the CIV units are more likely to be held both by treaty-entitled persons and non-treaty-entitled persons, the portion of treaty-entitled investors is likely to remain relatively constant unless the CIV begins distributing its shares in a new country that does not have an extensive treaty network.

A CIV generally determines every day its net asset value (NAV). A CIV's NAV is calculated by determining the CIV's gross assets, subtracting gross liabilities, and dividing by the number of shares outstanding.

NAV, consequently, is the per-unit value of an investment in a CIV. Open-end CIV interests are purchased and sold at NAV. For CIV interests that trade on stock exchanges, NAV determinations also are relevant because they inform supply and demand for NAV units at a given market price.[15]

CIVs have a keen interest in certainty regarding their eligibility for treaty relief because withholding taxes and treaty relief affect NAV. Specifically, withheld taxes expected to be recovered are an asset; taxes owed but not yet paid are a liability. The less accurate an estimate of expected treaty relief, the more likely a CIV's NAV will be inaccurate—causing investors to pay too much or receive too little when they purchase or sell CIV units.

Because of the daily changes in a CIV's investor base, however, income streams (such as a dividend received on 15 June) are not tracked to particular investors (such as those owning interests in the CIV on 15 June). Instead, when a CIV makes a distribution, the distribution is allocated pro rata

15 If a CIV is trading on a stock exchange at a price that diverges substantially from its NAV (say, trading at 12x or 8x when the NAV is 10x), investors may view the divergence as a good reason to sell (receiving 12x for a unit when the underlying assets are worth 10x) or buy (paying 8x for a unit when the underlying assets are worth 10x).

to all of the investors in the CIV (based on the number of units owned as of the date of the distribution).

Difficulties Faced by CIVs in Claiming Treaty Relief

The 2018 paper notes the difficulties faced by CIVs claiming treaty relief. The difficulties are of two kinds: (1) administrative difficulties faced by most CIVs in determining precisely the tax residency of their investors and/or making these determinations with the requisite frequency; and (2) legal difficulties faced by many CIVs in meeting treaty-eligibility legal requirements that were designed for operating companies rather than investment pools.

These difficulties, and the need for clarifying guidance, have been exacerbated by recent developments (including BEPS-related concerns) and policy responses (such as requiring minimum standards, such as the principal purpose test, for treaty relief). These developments inform our view that additional guidance is essential and that this guidance address emerging issues such as ensuring treaty relief for equivalent beneficiaries.[16]

Before discussing these CIV-level difficulties, we must note that it is not possible as a practical matter for CIV treaty benefits ever to be recovered based upon a claim filed by an individual CIV investor. Indeed, we are not aware of a single instance in which a CIV investor has even tried to claim his or her share of treaty relief after a CIV's claim has been denied.

There are several reasons why these individual claims never have been made. First, CIVs typically do not provide investors with information regarding the date and amount of each income payment received and the amount of tax withheld—all of which would be required to make a claim. Second, even if that information were provided, the investor would not know his/her proportionate interest in the CIV as the number of shares outstanding (the denominator in such a calculation) changes every day. Third, even if this information were available (which it is not), the potential treaty benefit that would be received by any individual CIV investor attributable to any income payment amount would be so small as to be outweighed by the cost of pursuing the treaty relief.

Turning to the CIV-level difficulties, the CIV manager—given the intermediated nature of most CIV's distribution networks—typically does not know the identities of the CIV's investors. While the distributors in the highly-regulated environment in which CIVs are sold do know these investors, and the investors' tax residencies, this proprietary customer information is not shared freely with the CIV managers (who also may compete directly with the distributors in other investment-related endeavors).

CIVs generally can acquire information about the tax residencies of their investors—but the cost of obtaining this information can be high and the level of detail (beyond tax residency) may be low. Thus, CIVs are better positioned to claim treaty relief when, for example, they are required only to provide "pooled information" (regarding the tax residency of groups of investors) once a year.

16 Equivalent beneficiaries are persons who are not residents of either of the two treaty partner countries—Source Country A and Fund Residence Country B—but who are resident in a third country (Investor Residence Country C) that has an income tax treaty with Source Country A that provides "equivalent" rate relief. Assume, for example, that the Country A-Country B treaty reduces the Source Country A withholding tax rate on dividends to 15% and the same (or better) treaty relief is provided by Source Country A to investors resident in Country C. Unless Residence Country C investors are treated as "good" investors (i.e., as equivalent beneficiaries) for purposes of Source Country A's treaty with Fund Residence Country B, these investors would be harmed by investing in a Residence Country B fund compared to the relief that they would receive by investing instead in a Residence Country C fund making the same investment in Source Country A.

Difficulties and costs increase rapidly when CIVs are required to provide more detailed information on a quarterly or monthly basis.

CIVs also face legal difficulties in claiming treaty relief. As the 2018 paper notes, these difficulties arise because of uncertainty regarding the extent to which certain CIVs may claim treaty benefits in their own right and when they must claim on behalf of their investors.

The 2018 paper discusses the specific requirements that a CIV must meet to claim treaty relief in its own right. These requirements—that the CIV be a person, that the CIV be a resident of a contracting state, that the income be attributable to the CIV for treaty purposes, that the CIV be the beneficial owner of its income, and that there be no situation of abuse (such as treaty shopping)—are met by many CIVs. If a CIV does not satisfy these requirements, the only practical manner in which the CIV's investors may receive treaty benefits in "non-abusive" situations is for the CIV to make claims on their behalf.

CIV-Specific Changes to the Model Convention Commentary

From the CIV industry's perspective, it is imperative that CIVs be able to claim treaty relief directly (when the CIV meets all legal requirements) or indirectly on behalf of treaty-eligible investors. Individual investors, as explained above, have neither the necessary information nor the individual financial incentive to incur the costs involved in pursuing treaty claims with respect to their CIVs' investments.

To address these difficulties, we support inclusion in the UN's Model Convention Commentary of CIV-specific guidance. This guidance must provide mechanisms—which will vary based upon differences in how the CIVs are organized and operated (as a legal matter) and distributed (as a practical matter)—by which all CIVs can claim treaty relief either directly or on behalf of their investors. There simply is not a "one size fits all" solution.

Some CIVs (including both domestically and globally distributed CIVs), we submit, meet every applicable requirement to receive treaty relief in their own right. Many of these CIVs also typically would recover essentially all of the potential relief if, instead, they were claiming relief only to the extent of their eligible investors. CIVs that are sold only in their domestic market—which can occur because of tax or securities law reasons or because of cultural preferences—should be presumed to be held only by the domestic residents. This presumption also would be subject to any applicable anti-abuse limitations such as a principal purpose test.

CIVs that cannot claim full treaty relief in their own right, as noted in the 2018 paper, also must be given the opportunity to claim treaty relief to the extent of their eligible investors (including, we submit, those who are equivalent beneficiaries). The mechanisms by which this relief is provided can vary based upon the extent to which the CIV meets the applicable legal requirements.

We have two other suggestions for the Commentary. First, the Commentary should suggest memoranda of understanding (MOUs) between countries regarding the treatment of a country's CIVs. These MOUs would accelerate treaty eligibility clarification as treaty modifications can be time consuming. Second, the Commentary should support "practical and reliable approaches" to investor tax residency determinations. For example, where a CIV is distributed globally and does not meet every applicable requirement to receive treaty relief in their own right, investor information should be required annually; if market conditions suggest high ownership turnover, this information could be required more frequently—although no more often than quarterly.

Conclusion

The undersigned CIV industry associations strongly encourage the Subcommittee to develop CIV-specific Commentary for the UN Model Income Tax Convention. As a first step, we urge you to support item 3(b)(ii) of the provisional agenda for the Committee's eighteenth session when it is discussed on 25 April 2019. Thereafter, we urge you to develop Commentary that achieves our mutual interest in guidance that provides CIV investors with appropriate treaty relief and benefits source countries by eliminating inappropriate tax burdens that inhibit investment and economic growth. We stand ready to provide you with whatever technical assistance you need regarding how CIVs are organized and operated, how their interests are distributed, how the tax residencies of their investors can be determined, and what requirements are administrable as a practical matter.

* * *

Please feel free to contact the representatives at the associations signing this letter, at your convenience, for additional information.

Sincerely,

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NAREIT

Nareit[17] appreciates the opportunity to offer our comments with respect to the discussion draft (Discussion Draft) relating to "Proposed Changes to the United Nations Model Double Taxation Convention Between Developed and Developing Countries Concerning the Tax Treaty Treatment of Collective Investment Vehicles, Pension Funds and REITs" (UN Model Treaty)[18]. In particular, Nareit supports the inclusion in the Commentary on the UN Model Treaty of paragraphs that contain provisions to reduce the source country withholding tax rate on dividends distributed to small investors residing in one country with respect to their interest in a real estate investment trust (REIT) located in another country.

Discussion Draft

The Discussion Draft proposes including an additional provision in the UN Model Treaty concerning collective investment vehicles (CIVs) and also includes proposed additions to the Commentary on the UN Model Treaty specifically addressing REITs. These draft additions incorporate the Commentary on Article 10 and Article 13 of the OECD Model Convention describing REITs (OECD Commentary) and the application of tax treaties to distributions from REITs and dispositions of interests in REITs:

> In many States, a large part of portfolio investment in immovable property is done through ... REITs. A REIT may be loosely described as a widely held company, trust or contractual or fiduciary arrangement that derives its income primarily from long-term investment in immovable property, distributes most of that income annually and does not pay income tax

17 Nareit is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. Nareit advocates for REIT-based real estate investment with policymakers and the global investment community.

18 https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-07/Discussion%20draft%20CIVs%2022JULY20.pdf.

on the income related to immovable property that is so distributed. The fact that the REIT vehicle does not pay tax on that income is the result of tax rules that provide for a single level of taxation in the hands of the investors in the REIT. …

… **In the case of a small investor in a REIT, the investor has no control over the immovable property acquired by the REIT and no connection to that property**. Notwithstanding the fact that the REIT itself will not pay tax on its distributed income, it may therefore be appropriate to consider that such an investor has not invested in immovable property but, rather, has simply invested in a company and should be treated as receiving a portfolio dividend. Such a treatment would also reflect the blended attributes of a REIT investment, which combines the attributes of both shares and bonds. In contrast, a larger investor in a REIT would have a more particular interest in the immovable property acquired by the REIT; for that investor, the investment in the REIT may be seen as a substitute for an investment in the underlying property of the REIT. In this situation, it would not seem appropriate to restrict the source taxation of the distribution from the REIT since the REIT itself will not pay tax on its income.

(Emphasis added).

The proposed additions to the Commentary on the UN Model Treaty include language that countries could include in Article 10 of their tax treaties to accomplish this result by providing for the reduced source-country withholding tax rate for portfolio dividends to apply to REIT distributions to non-resident owners of less than 10% of the capital of the distributing REIT. The proposed additions further elaborate that countries may choose to use a different ownership threshold for this purpose. The proposed additions also include language that countries could include in Article 13 of their tax treaties to provide an exemption from source country tax for capital gains on dispositions of REIT interests by such owners.

Nareit believes that reduced source-country tax on REIT dividends to non-resident portfolio investors in REITs and exemption from source-country tax on dispositions of REIT interests by such investors is the appropriate policy. Therefore, Nareit urges the UN Tax Committee to finalize the proposed additions in the Commentary on the UN Model Treaty to highlight this policy and provide guidance on how this policy can be reflected in tax treaties that are based on the UN Model.

Recognition of special circumstances of REITs

By way of background, the increasing globalization of investments in and through REITs led to the OECD's work on tax treaty issues related to REITs, which resulted in the issuance of the OECD's 2007 report on REITs and the inclusion of REIT-related language in the 2008 update to the OECD Model Tax Convention. This work focused on the appropriate application of source-country withholding tax reductions provided under a tax treaty for dividends paid by a REIT that is resident in one of the treaty partner countries to an investor that is resident in the other treaty partner country. It also addressed the treatment of capital gains on disposition of a REIT interest by non-resident investor.

The OECD reconfirmed the treatment of REITs as residents with access to treaty benefits in connection with its work on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances). As described in the October 2015 final report on Action 6 ("Further work to be done"),[19] the 2017 update to the OECD Model Tax Convention includes in the Commentary to

19 Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6: Final Report, October 2015, para. 11.

Article 29 (Entitlement to Benefits) a reference to the treatment of REITs as residents as provided in the 2007 OECD report on REITs.[20]

The importance of recognizing the special circumstances of REITs in tax treaties is even greater now because today about 40 countries have adopted REIT rules[21] (including many developing countries) and several more are actively considering such legislation. Therefore, the inclusion in the Discussion Draft of proposed additions to the Commentary on the UN Model Treaty that include tax treaty provisions specifically addressing REITs is very timely.

United States Model Tax Treaty

In 1997, the United States Treasury Department modified the REIT-related provisions in its Model Tax Treaty (the US Model Treaty). Specifically, these provisions in the Model Tax Treaty reduce the otherwise applicable 30% withholding rate on REIT dividends to non-resident shareholders to 15% for individuals with 10% or smaller holdings of the REIT, as well as dividends paid by: i) a publicly traded REIT to any shareholder who holds a 5% or smaller interest in the REIT; and, ii) a publicly traded or non-publicly traded REIT, the holdings of which are substantially diversified, to a shareholder who holds a 10% or smaller interest in the REIT. Treasury Department testimony to the U.S. Senate in 1997 noted that this policy "takes into account that portfolio investments in a REIT whether by individuals or institutional investors may be indistinguishable in intent and results from similar investments in other corporate securities and should be afforded similar tax consequences in appropriate circumstances."

*****

Nareit is hopeful that the UN Tax Committee will finalize the Discussion Draft and incorporate into the Commentary on the UN Model Treaty the tax-treaty policy of reducing the source-country withholding tax rate applicable to the distribution of REIT dividends to portfolio investors in REITs and providing an exemption from source-country tax for capital gains on dispositions of REIT interests by such investors, which is reflected in the OECD Commentary and in the US Model Treaty. This reduced source-country tax appropriately treats REIT dividends to portfolio investors, and capital gains on dispositions of REIT interests by such investors, in a manner similar to other corporate dividends and dispositions of other corporate interests. This treatment facilitates cross-border investment in a way that is mutually beneficial to both countries that are parties to the treaty.

Thank you again for the opportunity to submit these comments. If you have any questions or would like further information, please do not hesitate to contact me at tedwards@nareit.com or (202) 739-9408; Catherine Barre, Nareit's Executive Vice President & General Counsel, at cbarre@nareit.com or (202) 739-9422, or Dara Bernstein, Nareit's Senior Vice President & Tax Counsel, at dbernstein@nareit.com or (202) 739-9446, if you would like to discuss this matter in greater detail.

[Signed Tony M. Edwards, Senior Executive Vice President]

RADHAKISHAN RAWAL

These comments are given in response to the Discussion Draft titled Proposed Changes to the United Nations Model Double Taxation Convention Between Developed and Developing Countries Concerning the Tax Treaty Treatment of Collective Investment Vehicles, Pension Funds

20 2017 Model Tax Convention on Income and on Capital, Commentary to Article 29 (Entitlement to Benefits), Nov. 21, 2017, para. 55 and fn. 2.

21 https://www.reit.com/investing/global-real-estate-investment.

and REITs (hereinafter referred to as "**UN CIVs discussion draft**"), released by the UN Tax Committee after its 20th session June 2020.

1. Potential adverse revenue implications of extending treaty benefit to CIVs

CIVs make portfolio investments in equity markets of various countries. The significant part of the income earned by CIVs is capital gains on sale of securities. Interest and dividend income would represent smaller proportions. Accordingly, implications of the proposed provision on taxation of capital gains need to be analysed.

Article 13(5) of the UN Model gives taxing rights to the source country when the participation by the non-resident exceeds prescribed % of the capital of the company resident of the source country. The relevant provision is reproduced:

> *Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company, which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least ___ per cent (the percentage is to be established through bilateral negotiations) of the capital of that company.*

Further, as per the guidance contained in the United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries 2019, the source country should be given taxing rights in terms of Article 13(5) when the participation in the company resident of source country is "substantial". It is further clarified that the minimum participation is often 25%. The relevant paragraph[22] is reproduced hereunder:

> *Paragraph 5 of the UN Model, which has no equivalent in the OECD Model, allows a state to tax gains on the alienation of shares in a company, or comparable interest such as interests in a partnership or trust, where the company or relevant entity is a resident if that state in which the alienation holds directly or indirectly (or has held at any time during the preceding 365 days) a substantial participation. The minimum participation is not specified in paragraph 5 but it is often 25 per cent. The 365-day rule is an anti-avoidance provision designed to ensure that a taxpayer cannot escape source taxation by selling off multiple small parcels of shares that together form a substantial holding.*

The regulatory provisions of the source countries generally restrict investment by a by CIV in a company resident of source country up to a particular limit. Thus permissible investment by a CIV in a company would typically be far below the threshold adopted under Article 13(5) due to regulatory restrictions. Even as per the internal policies of CIVs, investment in a single portfolio company would be capped. As a result of this, the source country would generally not have the taxing rights in terms of Article 13(5) over the capital gains earned by CIVs.

When CIV is not recognized as a "person" or "resident of a Contracting State"	**When CIV is recognized as a "person" or "resident of a Contracting State"**
Capital gains earned by CIVs is subject to tax in the source country as per its domestic law[23].	Capital gains earned by CIVs is subject to tax in the source country as per its domestic law.

22 Para 465 page no. 133-134

23 It is assumed that the domestic law of the source country does not have any exemption for the capital gains earned by CIVs.

CIV will not be entitled to claim treaty benefit.	CIV will be entitled to claim treaty benefit. CIV will claim benefit of Article 13(5) and the source country does not have taxing rights.
In absence of treaty benefit, source country will get tax revenue on capital gains earned by CIV.	When treaty benefit is extended to CIVs and the provisions of Article 13(5) of the UN Model are adopted in the tax treaty, the source country will lose the taxing rights on capital gains on portfolio investments. Capital gains earned by CIVs are huge and hence extension of treaty benefit to CIVs will result in significant loss of revenue to the source country.

2. Suggested approach

Considering the possibility of losing the tax revenue which is currently earned by the source countries, the source countries could be reluctant to adopt the proposed provision related to CIVs in their tax treaties.

Participation by CIVs in the capital markets of a country is important from the perspective of development of capital markets as well as creation of wealth in the economy.

The UN Tax Committee may consider:

- Detailing importance and benefits of CIV participation in the capital markets. This will help developing countries make informed decisions.

- Giving taxing rights, over the capital gains on portfolio investments made by the CIVs, to the source country in terms of Article 13(5).