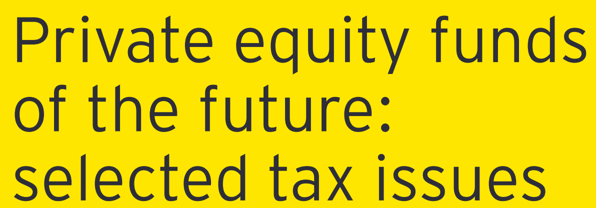

Private equity funds of the future: selected tax issues

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1 Executive summary

Investors and investment managers (**IMs**) generally have a strong preference for low-risk, tax-efficient private equity (PE) fund structures, especially those that span multiple taxing jurisdictions. Tax authorities (**TAs**) similarly prefer that taxpayers adopt low-risk approaches to tax. Unanticipated taxes can adversely affect investment returns, manager reputations and investor confidence, so it is paramount to understand the core business goals and objectives of the primary stakeholders. It is important to understand the current structures used by most IMs and whether there are tensions between those arrangements and the goals of the primary stakeholders that may require potential changes.

a. Private equity fund stakeholder goals

Investors seek financial returns while reducing other potential exposures that may accompany fund investing. From a tax perspective, this generally entails calculating potential cash tax risk, reducing the possibility of incurring incremental tax filing obligations in target and holding jurisdictions, and ensuring the availability of information sufficient to manage residence-jurisdiction compliance obligations. Institutional investors that historically have represented the core constituency for private equity generally have relatively low levels of risk tolerance on these points, and pension and sovereign wealth fund investors in particular may have environmental, social and governance (ESG) goals that include tax. Moreover, the appetite for tax risk can be expected to decrease further with the nascent democratization of investor interests.

IMs seek optimal financial returns through portfolio construction and applying operational expertise to portfolio companies (**PortCos**). The income generated tends to be primarily dividends and capital gains, with a preponderance of the latter, because free cash flow at PortCos tends to be applied primarily toward financing and operational improvements rather than toward current cash distributions.[1] IMs also closely protect their investor lists, and many investors prefer anonymity (although the proliferation of Foreign Account Tax Compliance Act (FATCA)/Common Reporting System (CRS)/know-your-customer (KYC) rules seems to have reduced anonymity concerns). IMs also are incented to maximize the use of experts and to minimize administrative expense, and, in tax, this frequently drives outsourcing to service providers.[2]

TAs administer domestic tax rules and apply tax treaties that modify or limit the application of those domestic rules in order to prevent double taxation. They also represent their jurisdiction within a larger treaty framework, such as the European Union (EU), and in multilateral standards organizations, such as the Organisation for Economic Co-operation and Development (OECD) and EU, both of which have grown steadily more prominent in tax policy and administration. For example, the OECD's base erosion and profit shifting project (BEPS) has produced standards for rules (now widely adopted) that reduce or eliminate perceived abuses of domestic law under so-called "hybrid mismatches" and earnings stripping,[3] and its two-pillar BEPS 2.0 project has made significant progress with many countries adopting Pillar Two.

b. Current private equity fund structures

Policy and legal background. In order to meet these goals, most funds employ a primary fund entity that is considered fiscally transparent where it resides,[4] which may be a taxing jurisdiction (e.g., Luxembourg, United States) or a tax-neutral jurisdiction (e.g., Cayman Islands). A variety of nontax commercial needs (e.g., ring-fencing investment liabilities, financing) lead private equity funds to hold investments through intermediate holding companies (IHCs). IHCs may also serve tax administrative goals, such as "blocking" investor-level tax filing obligations and steering clear of punitive "hybrid mismatch" rules. Such fiscally opaque holding arrangements generally preclude a fund investor from claiming benefits under a tax treaty between its residence jurisdiction and the investment/source jurisdiction. This, in turn, leads private equity funds to focus on IHCs that are eligible, in principle, to claim benefits, either under a tax treaty or under an EU directive (such as the parent subsidiary directive (EU PSD) or the interest and royalties directive (EU IRD), which may replicate or even exceed a tax-treaty benefit.

Treaty claims by IHCs may lead to perceived concerns about what is referred to by some as "treaty shopping," defined generally as when a person who is not a resident of a jurisdiction seeks to obtain treaty benefits available to residents of that jurisdiction. Those concerned with treaty shopping raise three core policy issues: incidence of benefit (i.e., effectively granting benefits to a person not part of, or contemplated by, the treaty negotiation); potential deferral of income for a nonresident owner of the IHC; and a disincentive to negotiate treaties with the source jurisdiction.[5] The OECD and its members have considered, over decades, two primary treaty-based responses that have not been uniformly adopted. The first involves detailed "limitation on benefits" clauses (LoBs) that evaluate treaty eligibility by reference to the entity's activities and/or ownership. The second is a standards-based approach, such as the "principal purpose test" (PPT) that evaluates the principal purposes of transactions or arrangements.

Evolution of private equity practice. Historically, private equity holding structures have evolved in response to legal developments. Where comparatively high tax rates, such as within the EU, increase the importance of tax efficiency, early approaches using single-asset IHCs that outsourced many functions have evolved toward regional platforms that hold multiple investments within a single entity that outsources fewer functions and likely has office space and employees. In other geographic areas, such as the Asia-Pacific region, lower rates relieve some of the pressure on tax efficiency within a fund, or IHCs may rely on more clearly defined local substance rules that regional jurisdictions generally accept.

As we look to the future, those structuring PE holding structures need to keep abreast of developments include the PPT standard and, particularly within the EU, potential convergence of the administrative practice for tax treaty claims with EU jurisprudence on claims under an EU directive (as reflected in the so-called Danish cases).[6] The commercial changes we have already seen in response to these developments include (1) greater IHC substance; (2) increased diversity of IHC jurisdictions, including where IMs reside in a bid to increase perceived IHC substance; (3) more intensive diligence by IMs on investor status; (4) increased availability and use of tax risk insurance; and (5) deferred treaty claims as long as possible (e.g., until exit).

c. Alternative policy paths

We see four likely paths for policy development concerning private equity fund holding company structures:

1. **Continue on the current path** to evolving greater IHC substance to support benefits under treaties and directives.
2. **Develop bright-line substance rules** for treaty and directive qualification.
3. **Develop a look-through/proportional benefits regime** that allows private equity funds to receive benefits that reflect claims their investors could properly make if they had invested directly rather than through a fund.
4. **Reduce statutory tax liabilities** on investment income and gains to a level (e.g., 10%) **reduces the prominence of taxation among the many considerations when making and structuring investments.**

The following discussion begins by addressing key considerations for each of the several constituencies (investors, IMs, TAs) in turn. It then summarizes the development of current commercial practice in private equity tax structuring and further discusses the likely paths for future policy development and structuring.

2 Selected investor considerations

Historically, private equity investors have focused on a limited list of tax items. Broadly, these fall into categories of investor-level administration and economics. In an ESG-focused environment, the list has expanded, particularly among institutional investors, such as pension plans, to include a variety of concerns, even when there are no explicit legal requirements to do so. The following discussion examines, in turn, tax-related ESG considerations, administration issues and economics.

a. ESG

In recent years, a variety of nongovernmental organizations, such as the United Nations, the OECD and the Global Sustainability Standards Board, have developed sustainability-focused operational and reporting guidelines and standards, which have become part of ESG considerations.[7] Many of these have been developed to include guidelines on taxation, mostly concerning risk management (e.g., publicly available policies and executive accountability) and information disclosure (e.g., "country-by-country" reporting).[8] In turn, many institutional investors (particularly pension plans, both public and private) have adopted investment activity "codes of conduct" that address many aspects of institutional investing, including taxation.[9] Governments have developed, and are developing, standards for tax risk management.[10]

As further discussed below, in connection with IM considerations, some elements of ESG-oriented concerns are relatively easily defined and applied (e.g., prohibiting use of an IHC formed or resident in specified prohibited jurisdictions), while others require interpretation of standards that may not yet have substantial legal content (e.g., requiring a specified level of confidence that IHCs satisfy any applicable PPT).

b. Tax-related administration

Investor concerns with tax administration take a variety of forms, but tend to concentrate on the receipt of information in a timely manner, incremental new net tax filing and payment obligations, and equitably allocating tax burdens and benefits incurred within the fund.

Information requirements. At the most basic level, an investor may require information beyond the fund financial statements in order to meet its local tax compliance obligations. Market practice typically obligates a fund to provide only financial statements, plus any tax reporting that it is legally obligated to provide. Investors who need additional information may negotiate for the provision of specialized tax information, typically at the requesting investor's expense. This is typically addressed via side letters with investors.

Incremental tax return filing obligations. Investors almost universally are highly averse to any incremental obligation to file a tax return on net income outside of their tax residence jurisdiction solely as a result of investing in a private equity fund (this may be the case for non-US investors regarding any US net income tax filing obligation). Such incremental filings can be an unwelcome administrative obligation relative to the investment (consider an investor that commits 1% of its investment capital to a particular fund that makes 20 investments, one of which results in a filing obligation), may attract additional scrutiny of the investor or its holdings in the relevant jurisdiction and may risk causing income unrelated to the fund investment to become subject to tax in the filing jurisdiction.[11] In contrast, most investors are not reluctant to provide information about themselves or make gross-basis return filings in order to claim reductions of gross-basis withholding tax (**WHT**), particularly in view of identity disclosure resulting from FATCA, CRS and KYC rules. Accordingly, fund investors typically receive assurances from the fund only that they will not be obligated to file net income tax returns solely as a result of an investment in the fund.

Incidence of withholding or similar payments of tax. Finally, investors commonly seek assurances that incremental tax filing and payment obligations imposed on the fund due to the action, inaction or status of another investor are borne solely by that investor to the extent possible. For example, FATCA incents compliance by imposing a withholding obligation if all investors do not provide certain information, and compliant investors understandably want assurance that adverse consequences will fall on noncompliant investors to the extent possible. By the same token, an investor whose status entitles the fund to a WHT reduction to the extent of that investor's interest reasonably might expect to retain that entire benefit, rather than sharing it with other investors. In contrast, the costs and risks of structuring that allows claims within a fund for benefits under a tax treaty or government directive are borne proportionately by all investors as a fund expense.

c. Tax considerations

Investors seek to maximize investment returns, subject to any other considerations that may supersede that goal. Each investor's tax circumstances may be unique, and the tax concerns of some investors may compete with those of other investors. The fund GP has a fiduciary obligation to all investors and a limited ability to accommodate particular concerns of any individual investor to the detriment of others. Offering documents typically specify that any particular investor's tax treatment may not be optimal from that investor's perspective and indeed may be worse than if the investor had invested directly in the relevant asset rather than indirectly through the fund. Dedicated fund structures, such as parallel or feeder funds, may be employed for sufficiently large investor constituencies that share a particular sensitivity that may be managed with a fund structure.

For purposes of this discussion, the three most relevant types of tax are entity-level taxes on net income (frequently shorthanded as "company income tax" (CIT)), notwithstanding that the entity may not be a company); WHT, which is most often a tax on a nonresident's gross dividend or interest income and collected by the resident payer; and taxes on disposition gain (frequently shorthanded as "capital gains tax" (CGT)).[12] Other types of tax (such as VAT) typically are not material to the fund overall, but their presence or absence may affect other tax-relevant determinations, such as whether an IHC qualifies as substantial for purposes of benefiting from a treaty or directive.

These taxes may apply at several levels within a fund structure, whether at the level of the fund entity itself, a PortCo, or at any IHC between PortCo and fund. At the fund level, the market expectation is that the pooling vehicle to which investors make commitments will be neither subject to CIT nor obligated to withhold on distributions to investors. We see IM operational teams increasing their attention to PortCo CIT.

Investors tend to focus primarily on WHT and CGT anywhere between PortCo and fund. Institutional investors and industry groups have expressed the view that, as a policy matter, they should be entitled to the same tax results (and, in particular, treaty benefits) whether investing in an asset directly or through a fund (sometimes described as investor equivalence).[13] It should be noted that this position can be in tension with investors' desire for protection from incremental return-filing obligations: Jurisdictions that tax nonresidents on capital gain as a baseline matter and grant reduced rates under tax treaties commonly require a nonresident to file an income tax return as a condition of claiming those tax treaty benefits.[14] Investor equivalence has considerable strength as applied to collective investment vehicles (**CIVs**) — widely held, open-ended, regulated funds that invest in a diversified portfolio of public securities — and the OECD has endorsed it there.[15] It is substantially less robust as applied to private equity for at least two reasons. First, investors commonly would be unable to access a private equity investment without the fund. Second, private equity often employs a variety of IHC structures that tend to be incompatible with investor treaty claims by investors. Some investors have sought to align manager and investor interests by insisting that carry should be taken on after-tax fund returns, but market practice more commonly determines carry on pretax returns.[16]

In summary, institutional investors (at least those in jurisdictions with substantial treaty networks) in private equity generally want the same tax results they would get if they invested directly, provided that they can get information they need for their own tax compliance, their ESG standards are met, and they do not have to file an income tax return.

3 Select investment manager considerations

This section discusses key IM considerations regarding legal entities when operating a fund, including the fund entity itself and the wide variety of considerations that inform the use of intermediate holding entities. It also addresses typical IM approaches to fund, PortCo and IHC operations.

a. Fund entity

Limited partnerships commonly satisfy a general partner's corporate-law need to accommodate highly flexible economic sharing arrangements (particularly as compared with corporate entities denominated in shares) with limited liability for investors while commonly enjoying fiscally transparent status under local tax rules. As a result, limited partnerships are the most common type of fund entity in private equity. A variety of considerations inform the choice of fund formation jurisdiction. Fund-level activity must be carefully monitored in light of the chosen jurisdiction to identify potential tax or tax return filing obligations that may arise for the fund or its investors.

b. Investment holding arrangements

i. Purposes

Beyond the fund entity itself, it is necessary to consider holding arrangements below the fund, which, for a variety of reasons discussed below, rarely hold PortCos directly.

Separating and containing potential liabilities. Funds commonly seek to ring-fence individual assets (or even a bidding/negotiation process, for that matter) from the rest of the portfolio by holding each in a special purpose vehicle (**SPV**).[17] Corporate lawyers typically prefer companies rather than partnerships for this purpose, particularly because there is often a single owner or simple proportional economics and vote.

Financing. Intermediate entities may also facilitate debt financing, whether at or above PortCo. For example, secured lenders typically want a pledge of the borrower's shares made by the borrower's immediate owner. Lenders may be able to lend to, take pledges from and take pledges of interests in entities that are not companies. Even so, they commonly prefer companies, both as pledgors and as security.

Blocking potential filing obligations/administrative goals. IHCs typically are used to protect fund investors from exposure to potential tax return filing obligations. Such obligations can arise in the source jurisdiction and/or the IHC's residence jurisdiction and typically fall to the first person in the ownership chain that the source jurisdiction considers fiscally opaque. For example, if an IHC seen as fiscally opaque by a source jurisdiction disposes of a PortCo, then, typically, any tax filing obligation would fall to the IHC alone and not its owners.

Preventing hybridity issues. It may also be important to use an entity seen as fiscally opaque by all relevant jurisdictions in order to steer clear of hybrid-mismatch rules potentially applicable to legal entities or arrangements seen by some jurisdictions as fiscally transparent, and by others as fiscally opaque.[18]

In summary, a typical private equity fund has good nontax commercial reasons, and good tax administrative reasons, to hold assets in fiscally opaque structures, and the OECD has acknowledged as much.[19]

ii. Selected considerations

Once having concluded that an IHC is needed to hold one or more investments, the focus turns to considerations guiding the choice of entity.

A variety of considerations motivate choice of jurisdiction, including political stability; well-developed and enforceable rules of corporate governance and contract; the availability of a skilled workforce, including service providers; access to banking, finance and the worldwide financial system; the jurisdiction's tax posture and reputational and legal standing in the global community (e.g., whether the jurisdiction is on a restricted list or otherwise noncooperative with an information exchange, such as the CRS); and the availability of high-quality office space.

An IHC's residence jurisdiction may exempt certain types of income, such as dividends and gain from sale from local CIT (e.g., under a participation exemption). However, such exemptions may not apply to other common types of income, such as gains from interest-rate and currency hedges that are not integrated with the hedged asset.

IHC distributions may be exempt from WHT under local tax rules (e.g., distributions of profit under an integrated CIT regime, under a holding company regime). IHC capitalization choices may be able to address potential WHT in other cases.

Finally, IHCs considered fiscally transparent by a PortCo's residence jurisdiction generally preclude fund investors from claiming either treaty or EU Directive benefits that might be available if they held the portfolio investment directly. However, an IHC considered fiscally opaque by a PortCo's residence jurisdiction might, in principle, be able to claim a treaty benefit or EU Directive benefit in its own right. The framework and particulars of such analyses are among the key subjects addressed in Section 4.

c. Operations

The fund GP or equivalent typically outsources responsibility for all day-to-day fund operations to the IM. The IM's expertise is primarily in investment analysis and PortCo operational expertise, so, typically, it outsources other fund operations (e.g., fund accounting, investor financial and tax reporting) to external service providers as much as possible. Such expenses typically are borne by the fund rather than the IM, so there is also a financial incentive to outsource.

IM operational expertise can be applied to PortCos in a variety of ways. For example, IM personnel typically are appointed (by the chain of holding entities ultimately controlled by the GP or equivalent) to serve on PortCo's board of directors. IM personnel often are included among an IHC's board members, subject to IHC residency sensitivities where the IM and IHC are in different jurisdictions. IMs may provide consulting services directly to PortCo, or may second personnel to PortCo on a longer-term basis.

4 Select tax policy/government considerations

Governments establish tax policy (such as defining the tax base and the tax treatment of nonresident investment capital) and create rules to implement that policy. TAs are tasked with administering the applicable tax rules, including claims under tax treaties and government directives, guided by the policy choices that informed the creation of those rules.

This section discusses some theories of tax treaty rationale and operation, and then considers some of the specific treaty terms that implement those concepts in the context of private equity fund investment and particularly IHCs. This background and history lead to a discussion of the OECD's efforts to address issues specific to the investment industry, first with CIVs (which are generally seen as sympathetic but conceptually knotty) and non-CIV funds (such as private equity). The discussion then briefly considers the same points for the EU PSD before turning to key features of claims administration for both treaties and the EU PSD.

a. Tax treaties

i. Theory

Tax treaties have several stated purposes, but the present discussion is concerned with only the prevention of double taxation. The theory for preventing double taxation is relatively straightforward. Traditionally, states accept the primacy of taxing claims based on source of income, but states also tax persons based on residence. If source jurisdiction and residence jurisdiction both claim the right to tax the same income at the same time, then the economic activity generating the income may be taxed twice, which can impact economic activity in the jurisdiction. Faced with the potential loss of economic activity, the relevant jurisdictions may agree to allocate taxing authority between them.

An intermediary or intermediate legal entity between residence jurisdiction and source jurisdiction complicates treaty application by raising questions regarding concurrent claims. By way of a brief example, a nominee ordinarily is not considered to have an economic claim on income, and the principal (and thus the principal's residence jurisdiction) does, so only a treaty between the source jurisdiction and the principal's residence jurisdiction ordinarily would apply. Under the OECD framework, a legal entity considered fiscally transparent by an owner's residence jurisdiction generally is treated as that owner's nominee.[20] If, in contrast, the owner's residence jurisdiction does not consider the entity fiscally transparent, then the owner's residence jurisdiction generally does not have a concurrent taxing claim.[21] This tends to preclude owner claims for source-jurisdiction treaty benefits, but it also raises the question whether the entity itself may be so eligible. Parsing such arrangements is at the heart of concerns over treaty shopping.

ii. Scope

As used by the OECD, "treaty shopping" generally refers to "arrangements through which a person who is not a resident of a Contracting State [that is party to a particular tax treaty] may attempt to obtain benefits that a tax treaty grants to a resident of that State."[22] Historically, the OECD has identified three policy concerns raised by treaty shopping. First, "treaty benefits negotiated between two States are economically extended to persons resident in a third State in a way unintended by the Contracting States; thus the principle of reciprocity is breached, and the balance of sacrifices incurred in the tax treaties by the contracting parties altered," (i.e., concern about the incidence of benefits).[23] Second, "income flowing internationally may be exempted from taxation altogether or be subject to taxation in a way unintended by the Contracting States. This situation is unacceptable because the granting by a country of treaty benefits is based, except in specific circumstances, on the fact that the respective income… at least falls under the normal tax regime of that State," (i.e., concern about deferral of taxable income for an owner of the entity claiming treaty benefits).[23.1] Finally, "[t]he State of residence of the ultimate income beneficiary has little incentive to enter into a [tax] treaty with the State of source, because the residents of the State of residence can indirectly receive treaty benefits from the State of source without the need for the State of residence to provide reciprocal benefits."[23.2] As applied to non-CIV funds, the BEPS Action 6 Final Report identifies incidence and deferral as the principal concerns with treaty shopping in non-CIV funds.[24]

iii. Qualification

The conditions for treaty qualification under the OECD Model have evolved over time, but, in its current form, a claimant generally must satisfy three conditions: claimant must be a "resident" (within the meaning of the treaty) of the relevant jurisdiction, claimant must be the "beneficial owner" (again, within the meaning of the treaty) of a payment with respect to which benefits are claimed, and the overall arrangement must comport with applicable anti-abuse provisions.

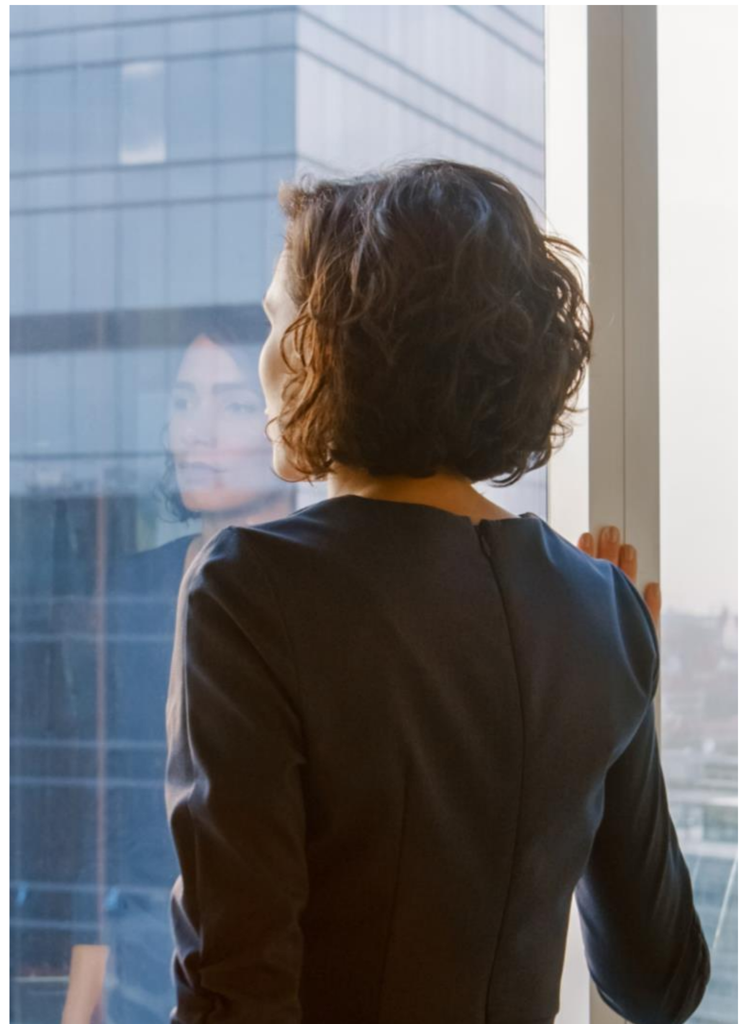
This subsection briefly discusses the resident and beneficial owner concepts before turning to a more expansive consideration of anti-abuse provisions. Starting from the OECD's recently established treaty anti-abuse baseline that includes both a specific anti-abuse rule (the LoB) and a more general anti-abuse standard (the PPT), the discussion considers their history and policy with an eye toward their importance for private equity.

A. Resident

Treaties are available to only the contracting states' "residents," generally defined as persons liable to tax under domestic law.[25] Residency of a legal entity for tax purposes typically is determined either by reference to its formation jurisdiction (e.g., as the United States does) or by reference to its situs of management and control (e.g., as most other jurisdictions do). These differences can give rise to dual residency or no residency, which can raise difficult tax policy questions.[26] Notably, "liable to tax" does not necessarily mean taxed in fact, but does mean taxable in principle, including exempt status.[27] Administratively, this is commonly evidenced by a tax residency certificate (**TRC**) issued by the relevant TA.[28] In contrast, fiscal transparency definitionally implies that liability to tax falls on the entity's owners. Thus, a fiscally transparent entity may not be a resident for treaty purposes, notwithstanding that it may be resident for other local tax purposes (e.g., filing obligations arising from local activity).[29]

B. Beneficial owner

The "beneficial ownership" concept has been part of the OECD Model since at least 1977.[30] The term went largely undefined in the OECD Model until 2002, when the commentary was modified to include an appeal to the notion of dominion and control, with agency as the counterexample.[31] Failing to qualify as a beneficial owner entails loss of the treaty claim, typically on the theory that the subject entity is acting as an agent for the owner/principal.



C. Anti-abuse

Overview. The BEPS project resulted in a minimum anti-abuse standard for inclusion in all OECD treaties: the common intention to eliminate double taxation without creating opportunities for nontaxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.[32] The OECD acknowledges that the minimum standard can be implemented in any of a variety of ways, but the most comprehensive approach combines a statement of intent that specifically abjures creating opportunities for treaty abuse, including treaty shopping, with a specific anti-abuse rule in the form of an LoB and a general anti-abuse standard in the form of a PPT.[33] Many jurisdictions apply a so-called substance standard to holding entities. The following discussion provides a brief overview of each of these in turn.

Principal purpose test. The amended preamble to the OECD 2017 Model provides that the Convention is intended in part to prevent double taxation without creating opportunities for nontaxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements.[34] The PPT added as part of the effort to achieve this goal allows denial of a treaty benefit "if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes" of the arrangement, "unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of [the] Convention."[35]

Drafters often try to give some content to such a "facts and circumstances" standard by providing examples, and the OECD 2017 Model includes several.[36] Among these, several relating to non-CIV funds were developed after other examples had been settled and after rejecting as too specific a variety of examples submitted by industry in response to an OECD request. Drafts of these three non-CIV examples (two of which are potentially in point for private equity; the third concerns a securitization arrangement) were published for public comment and ultimately were incorporated into the OECD 2017 Model commentary essentially without material change.

In Example K, a single institutional investor that is regulated in its residence jurisdiction establishes a regional platform with a single holding entity in a treaty jurisdiction that holds multiple assets across multiple jurisdictions and employs "an experienced local management team to review investment recommendations." The holding entity "pays tax" in its residence jurisdiction and has a more favorable treaty with a particular target jurisdiction than the investor's residence jurisdiction does.

In Example M, a real estate fund establishes a regional platform with a single holding entity in a treaty jurisdiction. The holding entity manages all of the fund's real estate assets, each of which it holds in a separate company in the relevant source jurisdiction in order to ring-fence liabilities and facilitate debt financing. All of the investors are equivalent beneficiaries.[37]

Comments from the non-CIV industry on public drafts of these examples focused on a variety of desired changes, including allowing Example K's holding entity to outsource activities; identifying Example K's holding entity as "taxable" rather than actually taxed; relaxing Example M to include a non-CIV majority owned by equivalent beneficiaries (in the same way that, in Example D, a CIV majority owned by equivalent beneficiaries passes the PPT); and defining "platform" in Examples K and M to include the use solely of per-asset SPVs in the holding jurisdiction, rather than a single aggregating entity. Some have taken Examples K and M to ratify in principle the viability of an aggregating holding entity.[38] However, because the OECD made no material changes in response to comments, it is difficult for a typical private equity fund owned by less than 100% equivalent beneficiaries to take much, if anything, more from the examples than that relevant factors include both in-house substance at an IHC, and whether an IHC's claimed treaty benefit exceeds the benefit an investor could claim on an unintermediated investment. With respect to the latter point, it should be noted that the multilateral instrument (MLI) developed to allow governments to quickly implement BEPS actions (see additional discussion in Appendix) includes optional discretionary facts-and-circumstances relief for PPT failure if benefits denied under a PPT "would have been granted … in the absence of the transaction or arrangement" (the term "equivalent beneficiary" is not mentioned), which, curiously few states have elected.[39]

The immediate consequence of failing a PPT obviously is losing the treaty claim, but the theory of disqualification can have further implications. For example, anti-abuse rules often (but not always) apply by ignoring the arrangement considered to be abusive, in which case it may be possible to analyze the facts considered as enduring.[40]

Substance. The concept of "substance" derives from the transfer pricing principle that the amount and location of income generally should align with the value and location of the various activities that generate it (e.g., as reflected in the BEPS Action Plan).[41]

A variety of tax contexts that are not necessarily about treaty qualification but share a similar analytical approach invoke substance as a guide. The OECD's 1998 report on harmful tax competition noted that one indicator of a potentially harmful regime is the ability to access it with few or no substantial activities relating to the relevant income.[42] That report recommended work on transfer pricing concepts to align income with activities, and, although the harmful tax project's focus evolved away from substance and toward transparency and information exchange, BEPS Action 5 renewed the focus on substance.[43] Similarly, the BEPS Action on controlled foreign corporation within the meaning of section 957 (CFC) invokes substance as an analytical factor.[44]

The EC's own formal efforts on substance date at least to the formation of the Code of Conduct (Business Taxation) Group, which noted in its 1999 report to the ECOFIN Council the absence of economic substance in tax-driven holding companies.[45] More recently, the EC has proposed an anti-tax avoidance directive (**ATAD 3** or **UNSHELL**) that defines presumptive substance standards applicable to all EU entities, with the stated goal of preventing EU resident entities from claiming benefits under an EU Directive or a tax treaty with an EU member.[46]

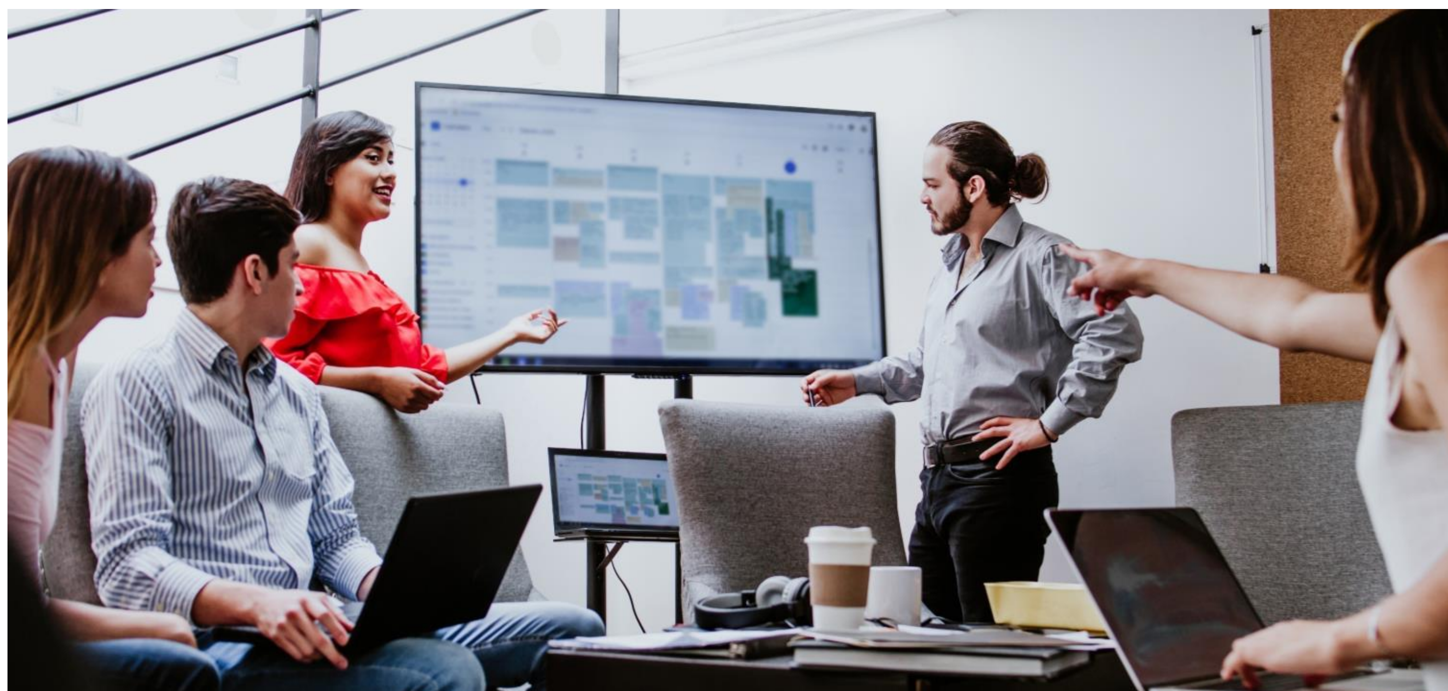
Limitation of benefits. The United States originally developed LoBs to address concerns about treaty shopping.[47] Although BEPS Action 6 introduced both "simplified" and "detailed" LoBs to the OECD 2017 Model, the bilateral complexity of the detailed LoB led the OECD to include in the MLI only the simplified LoB, of which there has been almost no uptake as of this writing.[48]

An LoB generally provides objective threshold conditions designed to ensure that treaty benefits go to only residents of the other contracting state and not to residents of third states that do not have a substantial business and tax nexus with the other contracting state.[49] The core objective test specifies both a minimum percentage ownership by persons resident in either of the treaty states (the **ownership test**), and a maximum portion of the entity's income payable in deductible payments to persons not resident in either contracting jurisdiction (the **base erosion test**). A savings clause affords discretion to grant benefits where an arrangement fails the objective test but does not fail the PPT.

The scope of acceptable beneficiaries has expanded with time, in many cases reflecting categories deemed "bona fide" in the OECD's 1986 report on conduit companies.[50] Among these categories, "derivative benefits" provisions allow a company that otherwise fails the core LoB to qualify if it is owned (either entirely or to some specified extent) by up to a specified number of equivalent beneficiaries, notwithstanding the heightened potential for deferral and incidence problems.[51]

EU nondiscrimination. LoB provisions have always raised concerns about the potential for impermissible discrimination under one or more of the "four freedoms" at the center of the EU.[52] For example, under a baseline LoB, an EU company with owners resident in the company's residence jurisdiction could receive better treatment than the same company if owned by persons resident elsewhere in the EU.[53] Derivative benefits provisions mitigate, but probably cannot eliminate, the possibility of discrimination.[54] In 2016, the European Commission ruled that the LoB in the Japan-Netherlands treaty infringes the "freedom of establishment" principle.[55] The Commission dropped the infringement claim in 2020 but presumably could take it up with the European Court of Justice in the future.[56] The OECD has alluded to EU nondiscrimination concerns in the LoB context and has noted them explicitly in the CFC context.[57]

PPT, CIVs and proportional benefits. Despite EU nondiscrimination concerns, the OECD has done considerable work on treaty claims by CIVs. The essence of it is that a CIV may or may not qualify for a given treaty on the basis of the CIV's particular legal characteristics and local laws, and source countries should have flexibility to grant benefits on the basis of their ownership, largely on the theory of investor equivalence.[58] For example, a rule could allow a CIV to claim residence jurisdiction treaty benefits if it is some minimum percentage owned by a combination of persons resident in the CIV's residence jurisdiction and equivalent beneficiaries, or to the extent of its ownership by equivalent beneficiaries (**proportional benefits**).[59] Alternately, a rule could allow the CIV to claim benefits on behalf of its treaty-eligible owners (rather than in its own name) if the relevant information can be developed.[60] The policy concern expressed in response to these approaches remains that any rule referencing ownership "changes the bilateral nature of a treaty negotiation," which is to say, raises deferral and incidence concerns.[61] Deferral seemingly can be addressed by limiting eligible CIVs to those that make annual earnings distributions.[62] Incidence appears to be mostly a problem of administration (i.e., developing and sharing the necessary information accurately and timely), as further discussed immediately below.



iv. Administration

The two primary approaches to implementing treaty-reduced rates involve either reduction at source (payer/withholding agent withholds and files relevant returns with the tax authority) or higher-rate withholding followed by an application for a refund. Claimants obviously favor reduction at source, but this establishes a tension between the payer's need to have information timely and the commercial sensitivity of that information, particularly where one or more intermediaries are present.[63] Following work by the informal consultative group on CIV treaty claims and administration, the OECD developed the tax reporting and compliance enhancement system (**TRACE**), which is designed to facilitate withholding reduction at source while protecting sensitive information from disclosure to other intermediaries, largely along the lines of the US "qualified intermediary" (**QI**) program.[64] TRACE provides in essence that source jurisdictions may approve "authorized intermediaries" (**AIs**), which collect investor information and provide it to the AI country's TA. The AI country's TA then shares that information with the source-jurisdiction TA, which, in turn, verifies investor treaty eligibility with investor-jurisdiction TAs. The AI can then provide payers with TA-certified pooled withholding information, thus removing payer withholding risk while providing TA compliance transparency and preserving commercial confidentiality.[65] No jurisdiction has yet adopted the TRACE scheme, but subsequent technological developments (including blockchain) allow industry to manage the considerable data necessary to implement TRACE, and TAs should have an interest in TRACE if that data can be standardized in a nonproprietary format.

b. EU parent-subsidiary directive

The EU's four freedoms may be affected by members' rules of taxation and thus may be the subject to EU legislation. The EU PSD is designed to eliminate any disadvantage to cooperation between companies of different EU member states, as compared with cooperation between companies within the same member state, by eliminating WHT within the EU on distributions from subsidiaries of previously taxed profits.[66] Thus, the EU PSD confers a benefit similar to a tax treaty and raises similar access issues, albeit with EU-specific variations. Many private equity funds hold investments in EU PortCos via EU-resident IHCs that claim the EU PSD.

The EU PSD is not self-executing and requires local implementing law. To qualify for the EU PSD, a distribution must be paid to a company that is both EU resident and owns 10% or more of the issuer, subject to a general anti-abuse standard. "Residency" means resident of an EU Member State under the laws of that Member State, and not resident outside the EU under the terms of a double taxation agreement concluded with a third state.[67] Notably, a typical private equity fund investor does not own a 10% interest in any PortCo and so would not be able to claim the EU PSD if its proportional interest in PortCo were held directly.

The EU PSD does not preclude domestic anti-abuse legislation.[68] However, the European Court of Justice has delineated some boundaries for permissible anti-abuse approaches. For example, wholly artificial arrangements may be abusive,[69] making it important for a taxpayer to demonstrate important nonfiscal reasons for the challenged arrangement.[70] Evaluation of abuse generally must take into account the facts and circumstances,[71] although ownership of an entity (e.g., by non-EU persons) generally is not relevant for this purpose,[72] except to the extent that ownership includes a jurisdiction deemed uncooperative with the information exchange.[73] EU jurisdictions are free to design their tax systems in ways that do not impose WHT,[74] although non-WHT arrangements may incent misuse of the EU PSD.

The European Commission has sought to develop anti-abuse standards of general application. ATAD 1 introduces, among other things, a general anti-avoidance concept that requires EU member states to ignore arrangements that have a main purpose of obtaining a tax advantage that defeats the object or purpose of applicable tax and are not established for valid commercial reasons that reflect commercial reality, and the Danish cases arguably represent a step toward incorporating something like the OECD's PPT into the EU PSD.[75]

ATAD 3 as proposed identifies three conditions that together create a rebuttable presumption that an entity is insubstantial: (1) most of its income is "passive" income, such as dividends, interest and royalties; (2) most of its assets and transactions are cross-border; and (3) the entity outsources the administration of day-to-day operations and decision-making on significant functions.[76] Once subject to the presumption, a wide variety of additional information must be reported, including whether the entity has dedicated premises, an EU bank account, board directors meeting certain criteria and proximately located full-time equivalent employees. Failing to rebut the presumption results in disregard of the insubstantial entity and denial of a TRC.[77]

5 Private equity fund structuring: commercial practice

Investment structuring for non-CIV funds and, in particular, the use of IHCs, has evolved with legal standards (and perceptions of legal standards) for substance, as discussed supra. When considering how private equity fund structuring may evolve, it is useful to consider the development of commercial practice regarding IHC employees, premises, and board composition and operation, three of the facts and circumstances commonly considered under substance analysis even before the proposal of ATAD 3.

As discussed above, the incompatibility of fund IHC structures with investor-level treaty claims commonly has led to the use of IHCs intended to be eligible for tax treaty or EU PSD benefits.[76] Historically, funds have held each asset in a separate IHC, which typically is resident in a jurisdiction other than the IM's. Ordinarily, the IHC does not conduct a large amount of activity over its life, even if some of that activity is particularly important; the most consequential matters include purchase and disposal decisions, and managing its interest in the asset (appointing and possibly instructing PortCo board members, voting its interest, pledging its interest, etc.), whereas less consequential matters that still are not extensive may include monitoring, bookkeeping, cash management and meeting such regulatory requirements as filing statutory accounts.

Less consequential IHC operational matters typically are outsourced. Dedicated office space ordinarily would not truly be needed in order to perform its functions, but practice here has varied. Some have leased dedicated office space in order to support a claim of physical presence, whereas others have viewed premises as inconsistent with the IHC's operating model and thus as potentially problematic, rather than helpful. Board composition and operations typically remain the items that merit careful attention. Ideally, IHC boards consist of persons qualified by experience and involvement in the business to make decisions; at least half of such persons reside in the same jurisdiction as the IHC, and the board holds physical-presence meetings in the IHC's jurisdiction for significant decisions. Even though an IHC's board ordinarily would include at least one person from the IM's investment team dedicated to the relevant PortCo, some members balk at traveling to board meetings, and finding qualified independent and trusted local persons for at least half of the board can prove difficult.

When there are many SPVs, the aggregate of the day-to-day functions may warrant dedicating a local person or a team to oversee the SPVs' operations. Most commonly, this has taken the form of the IM creating an office in the SPV residence jurisdiction, staffed by personnel who manage the day-to-day operations and often serve on SPV boards. The IM may then make its office space available to the SPVs, and the staff may provide some of the administrative services needed (e.g., bookkeeping and cash management) and oversee outsourcing of the rest (e.g., preparation of accounts), all paid for by the SPVs in the aggregate under a cost-sharing arrangement. Many view this as an incremental substance improvement relative to third-party outsourcing, but the core issue remains whether, or to what extent, the IM's premises and employees are attributable to any given SPV. This remains the case even if the SPVs are formed and meant to be resident in the same jurisdiction as an IM entity that employs investment personnel and senior management. Further improvement has been sought by itemizing costs within each SPV's accounts (rather than a single cost-sharing charge ultimately received by the IM) and by registering each SPV as a fractional employer for legal and tax purposes (even if a single entity, such as the IM, serves as a single paymaster/payment agent).

More recent developments in legal entity structures have consolidated per-asset SPVs under a single primary IHC that employs personnel and secures office space, thus bringing these elements of substance more clearly within the IHC ownership chain. Although it is not entirely clear whether or to what extent a parent entity's premises and employees can properly be attributed to a subsidiary, any determination that an SPV is insubstantial would, under many anti-avoidance regimes, leave the analysis to focus on the primary IHC.[78]

6 Possibilities for the private equity fund of the future

In view of the various participants' interests, we see four general paths for policy development concerning private equity fund structuring: (1) continue on the current path, (2) develop bright-line substance rules for IHCs, (3) develop a look-through/proportional benefits regime and (4) reduce statutory tax obligations on investment income and gains. No one option is clearly a "silver bullet" that reconciles all the goals of all participants, but each option can be evaluated for its appeal and limitations.

Continue on the current path. In the first path, continuing with current developments in various parts of the world generally would see in the EU (and possibly LatAm) continued use of IHCs seeking to claim tax treaty or directive benefits as substance standards are given more stringent content; in the United States, continued general absence of CGT for nonresidents and difficulty of treaty access due to tight LoBs; and in Asia-Pacific, varied approaches ranging from relatively low statutory tax burdens on nonresident investment (as in India and the People's Republic of China), to bright-line substance rules (as in Singapore) and preclearance (as in Australia).

Although most well-advised private equity platforms with a global reach understand their structuring needs and the attendant tax risks, "substance" standards as currently applied do not yet have enough content to provide clear and consistent guidance, never mind guidance that takes commercial needs and practice into account. The resulting uncertainty creates additional expense for IMs (e.g., in-house expertise and ongoing management) and TAs as IMs seek to determine acceptable practices, and an uneven playing field for IMs based on their willingness to take tax risks, rather than on their ability to make and steward investments.

Develop a bright-line substance rules for IHCs. The second path would be to promulgate bright-line substance rules that identify a clear path to tax treaty and government directive qualification and are consistent with commercial practice.

Clarity increases certainty and reduces risk, which levels the playing field for IMs and reduces cost and complexity to the extent possible for all parties. However, this certainty comes at the cost of limiting regulatory flexibility to address facts that may not have been contemplated when the rules were drafted, which can lead to unintended consequences.

Develop look-through/proportional benefits regime. A third possibility would be a look-through/proportional benefits regime that enables funds to claim treaty benefits on behalf of their treaty-qualified investors without investor filing obligations.

The primary tax policy argument favoring this approach is investor equivalence, a claim that is somewhat weaker for private equity than for CIVs (see discussion supra text accompanying notes 15-16). It would also bring the same clarity and certainty associated with a rule. Notably, proportional benefits treatment most likely would largely eliminate EU PSD claims in private equity because, typically no single fund investor owns a 10% interest in PortCo via the fund.

A proportional benefits regime would need to contend with policy, legal and administrative challenges. The key policy challenges are incidence and deferral. Incidence can be addressed (and in many cases already is addressed) within the fund documents. Deferral is largely addressed by a combination of using IRR as the primary metric of investment returns and GP incentive compensation, and the typically limited life of private equity funds. Perhaps against this background, there is anecdotal evidence of TAs applying look-through treatment on an ad hoc basis in an audit settlement.[79] The primary legal difficulty with wide adoption (at least within the EU) of a proportional benefits rule appears to be the inherent likelihood of discriminatory treatment based on ownership. There is no easy response to this problem, other than that a proportional benefit rule could reduce the reliance on EU-resident IHCs. With respect to the administrative challenges, the TRACE system provides a template, and developments in regulatory information requirements (FATCA/CRS/KYC) and technology make it increasingly viable.

Reduce statutory tax obligations. The fourth possibility would entail reducing statutory tax obligations to a level around 10. Obviously, this would be a significant fiscal and political choice for source jurisdictions; while a simple solution, it may prove difficult to implement across the globe.

Against the background of the preceding discussion, we do not foresee any imminent dramatic policy changes on the horizon; instead, we expect to see incremental development of substance standards, particularly within the EU. ATAD 3 has been proposed, but it is impossible to say how it will develop. In the meantime, structuring approaches to the resulting uncertainty and risk need to focus on developing and deploying substantive entities, likely in a wider variety of jurisdictions. Increased uncertainty may warrant greater consideration of the use of transactional tax liability insurance.

7 Appendix: overview of selected OECD projects

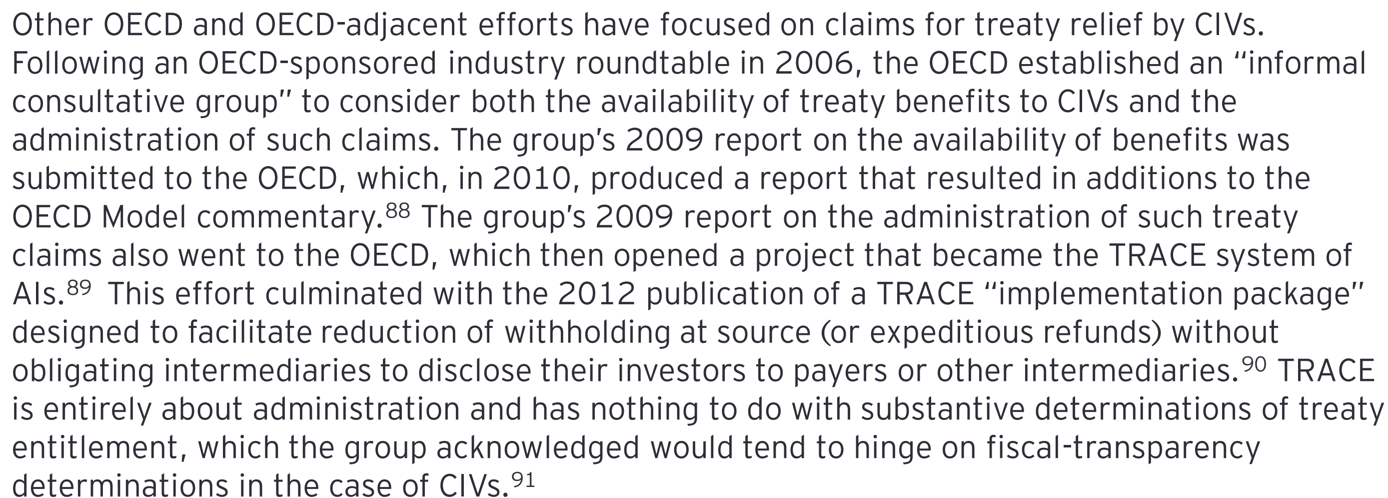
Inevitably, the discussion about treaties starts from the OECD Model and the extensive reports and commentary that inform it. This appendix is designed to provide an overview of the many different reports and projects that inform the discussion in this note.

The OECD members are the world's most developed jurisdictions. All are engaged in extensive global trade, so there is a fair expectation that all members will both import and export capital. The OECD's Committee on Fiscal Affairs is responsible for work on all tax matters and historically a primary focus of this work has been the OECD Model Convention, including commentary and related analytical reports, all of which are designed to assist with negotiating and interpreting treaties. The OECD Model Convention has no legal weight, but it is regularly sought out as a guide to the shared understanding of common treaty provisions.

Developing countries may apply a different calculus to cross-border tax policy than most OECD economies. In 1980, under the auspices of the United Nations, non-OECD jurisdictions published a model tax convention that tends to favor the considerations of "source" jurisdictions that are much more likely to import capital than to export capital (the **UN Model Tax Convention**). In consequence, the UN Model Tax Convention "favours retention of greater so-called 'source country' taxing rights … as compared to those of the 'residence country' of the investor."[81] The UN Model does not have the extensive commentary and reports of the OECD Model, but the fundamental tax policy issues are similar. This note makes extensive reference to the OECD Model associated material and other OECD projects.

The most relevant OECD study points for this note concern treaty shopping, defined as using an entity to access a treaty whose benefits would not otherwise be available to the entity's owners.[81.1] The earliest reprinted reports on this topic are those issued in 1986 concerning base companies[82] and conduit companies. The fundamental concern with base companies was deferral — shifting income to low-tax jurisdictions, where it would remain largely untaxed, at least until repatriated, and possibly indefinitely. Very generally, the concept was to focus on transfer pricing (insisting on alignment of income with activities giving rise to the income), and anti-deferral regimes, such as CFC type rules.

The OECD issued its first report on "tax havens" in 1980, and this was followed by another in 1987, which appeared as part of a volume of four related studies.[83] At the direction of the G7 in 1996, the OECD opened a project on "harmful tax competition."[84] Originally, this focused on the potential "race to the bottom" fomented by low-tax jurisdictions, but the project expanded beyond OECD membership with the development of the Forum on Harmful Tax Practices (created as a subsidiary body of OECD's Committee on Fiscal Affairs). Following US government reconsideration under the George W. Bush administration of the propriety of condemning tax competition,[85] the project evolved to focus more on transparency and information exchange and reconstituted the wider group as the Global Forum on Taxation, which adopted standards and principles for effective exchange of tax information. The Global Forum on Taxation later became the Global Forum on Transparency and Exchange of Information for Tax Purposes.[86] Within the OECD, work continued to focus on the improper use of tax treaties, and, in 2002 it published a report on tax treaty abuse, largely driven by the harmful-tax-practices project.[87]



Other OECD and OECD-adjacent efforts have focused on claims for treaty relief by CIVs. Following an OECD-sponsored industry roundtable in 2006, the OECD established an "informal consultative group" to consider both the availability of treaty benefits to CIVs and the administration of such claims. The group's 2009 report on the availability of benefits was submitted to the OECD, which, in 2010, produced a report that resulted in additions to the OECD Model commentary.[88] The group's 2009 report on the administration of such treaty claims also went to the OECD, which then opened a project that became the TRACE system of AIs.[89] This effort culminated with the 2012 publication of a TRACE "implementation package" designed to facilitate reduction of withholding at source (or expeditious refunds) without obligating intermediaries to disclose their investors to payers or other intermediaries.[90] TRACE is entirely about administration and has nothing to do with substantive determinations of treaty entitlement, which the group acknowledged would tend to hinge on fiscal-transparency determinations in the case of CIVs.[91]

The OECD's BEPS had its germ in the 2008 great financial crisis, but OECD work began in earnest with the February 2013 report titled "Addressing Base Erosion and Profit Shifting," and the OECD and G20 endorsed a 15-point action plan in September 2013. BEPS refers generally to tax planning strategies that exploit gaps and mismatches in tax rules, either to artificially shift profits to low- or no-tax locations where there is little or no economic activity or to erode tax bases through deductible payments, such as interest or royalties.[92] It included several areas of study, including most relevantly for present purposes, BEPS Action 2 ("Neutralizing the Effects of Hybrid Mismatch Arrangements"), BEPS Action 5 ("Harmful Tax Practices"), BEPS Action 6 ("Prevention of Tax Treaty Abuse") and BEPS Action 15 ("Multilateral Instrument"). The various BEPS Action Plan final reports were issued in 2015. BEPS Action 6 included work on CIV treaty eligibility and qualification for the **PPT** introduced to the OECD Model Treaty by BEPS Action 6, although the BEPS Action 6 Final Report acknowledged that more work was needed on non-CIV funds.[93] The work on non-CIV funds produced commentary and examples.[94]

The various BEPS actions resulted in changes incorporated in the 2017 OECD Model. In order to streamline widespread adoption into existing treaties of the new minimum standards and other developments, without the lengthy and unwieldy process of seriatim negotiation with each individual counterpart, the OECD created a novel multilateral instrument (the **MLI**) that can incorporate changes across all of a jurisdiction's treaties where counterparties do the same. An MLI "tracker" of elections made by participating jurisdictions may be found at oecd.org/tax/treaties/mli-matching-database.htm.

End Notes

Note: ¶ indicates paragraph, and ¶¶ indicates multiple paragraphs.

[1] Classical private equity funds may also generate dividend income from so-called dividend recapitalizations, and different investment strategies (such as infrastructure funds) may focus more on current cash distributions.

[2] As further discussed below at Section 3, private equity funds are most commonly organized as limited partnerships, with a general partner ("**GP**") responsible for making all decisions of consequence for the particular fund (e.g., investment and disposal). The GP typically engages an IM to provide investment analysis and advice to the GP; provide or oversee the provision of administrative services to the fund; and, increasingly, provide operational expertise to portfolio companies. The distinction between GP and IM is very important for a variety of reasons and is therefore carefully maintained. Without intending to degrade that distinction in any way, for ease of use, this note generally refers exclusively to the IM.

[3] For a summary and history of the (many) projects undertaken by the OECD's Center for Tax Policy and Administration that are referenced in this note, please refer to the Appendix: overview of selected OECD projects.

[4] The OECD defines fiscal transparency as "situations where, under the domestic law of the Contracting State, the income… of the entity or arrangement is not taxed at the level of the entity or arrangement but at the level of the persons who have an interest in that entity or arrangement," with timing, character and source in the hands of the person with an interest unchanged by the entity or arrangement. OECD (2019), Model Tax Convention on Income and Capital 2017 (Full Version) ("**OECD 2017 Model**") at C(1)-5 at ¶9. The EU applies the same concept where relevant. See, e.g., Council Directive 2003/123/EC at ¶6 (fiscal transparency affects application of EU PSD).

Residency is further discussed infra Section 4.A.iii.a.

[5] IHC arrangements can also result in changes to the character of income paid or distributed by an IHC relative to the character of income received by the IHC, as seen by the residence jurisdictions of either or both of the IHC itself and its owners. The OECD has described this as "secondary sheltering" and over time has focused almost exclusively on rules that align amount and timing, even in the so-called hybrid mismatch rules. See, e.g., OECD, Double Taxation and the Use of Base Companies, reprinted in OECD 2017 Model as R(5) at Section VI (Questions of Secondary Sheltering), pp25ff. More recently, see OECD (2015), Neutralizing the Effects of Hybrid Mismatch Arrangements, Action 2 – 2015 Final Report ("**BEPS Action 2 Final Report**"), at ¶¶ 12-14 (focus on making deductible financing costs includible as ordinary income, character changes unaddressed); OECD (2015), Designing Effective Controlled Foreign Company Rules, Action 3 – 2015 Final Report ("**BEPS Action 3 Final Report**") (not explicitly addressing character changes as part of CFC rules); OECD (2015), Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report ("**BEPS Action 6 Final Report**") at 69-70 ¶¶32-33 (deferring consideration for another day).

[6] *N Luxembourg 1 and Others v. Skatteminsteriet* (N Luxembourg 1) joined cases C-115/16 [N Luxembourg 1], C-118/16 [X Denmark A/S], C-119/16 [C Danmark I], and C-299/16 [Z Danmark ApS] (CJEU 26 February 2019); and *Denmark v T Danmark* joined cases C-116/16 [T Danmark] and C-117/16 [Y Danmark] (CJEU 26 February 2019). See N Luxembourg 1, C-115/16, 1 Mach 2018; T Danmark, C-116/16 (1 March 2018); Y Danmark, C-117/6 (1 March 2018); 2021/0434 (CNS) (Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU).

[7] See, e.g., "UN Principles for Responsible Investment," (2006) www.unpri.org; "UN Guiding Principles on Business and Human Rights (2011); OECD Guidelines for Multinational Enterprises (2011); Global Reporting Initiative" (created 1997, produced sustainability reporting guidelines 2000, published first standard 2016; see www.globalreporting.org/about-gri/mission-history/.

[8] See, e.g., UN PRI, Engagement Guidance on Corporate Tax Responsibility (2015); UN PRI Reporting Framework for Private Equity (2021); GRI Standard 207: Tax 2019; World Economic Forum, Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation (2020) (white paper) at 78.

[9] See, e.g., "Commonwealth [of Australia] Superannuation Corporation Tax Code of Conduct," (2021) csc.sitecorecontenthub.cloud/api/public/content/6532b9d134e9476bb99d505a943386c7?v=bcf6311a; "Danish Pension Tax Code of Conduct," www.pensiondanmark.com/globalassets/dokumenter/investering/new-tax-code-of-conduct.pdf; "European Ass'n of Investors in Non-Listed Real Estate Vehicles, Code of Tax Conduct," (2021) www.inrev.org/guidelines/module/code-of-tax-conduct#inrev-guidelines; "Norges Bank Investment Management, Tax Transparency: Expectations of Companies," (2021) www.nbim.no/en/publications/.

[10] See, e.g., Regulation (EU) 2019/2088 (Sustainability-related disclosures in the financial services sector); UK requirements for tax strategy publication, available at www.gov.uk/guidance/large-businesses-publish-your-tax-strategy#mne-groups; UK requirements for appointment of a senior accounting officer, available at www.gov.uk/hmrc-internal-manuals/senior-accounting-officers-guidance.

[11] The resistance to net income tax filing obligations could in theory be subject to a cost-benefit analysis for a given investor. However, making such judgments ex ante is essentially impossible because neither the potential benefit, nor in many cases whether filing will be required, can be known with complete certainty in advance. In addition, trying to optimize investment structures for particular investors not only is difficult and expensive, but can undermine claims of nontax motivation where a holding structure is not uniform across investors. See also infra Section 2.c (Selected Investor Considerations — Tax-Related Economics) and Section 3.b.ii.A (Selected Investment Manager Considerations — Intermediate Holding Entities — Selected Considerations).

[12] Tax rules often use "source of income" as a way of defining the tax base. For example, most developed countries treat capital gain as sourced with a seller (and thus as nontaxable in the hands of a nonresident seller), unless the asset either derives most of its value from immovable property, is considered held as part of a local trade or is held in a "tax haven" jurisdiction. Some jurisdictions provide an exception to these exceptions for transactions conducted on a qualifying public stock exchange. In contrast, developing countries typically export little capital and are more likely to retain the right to tax all capital gain in the hands of a nonresident. See also Appendix at n.1 and accompanying text (comments re United Nations Model Double Tax Convention between Developed and Developing Countries (2021)).

[13] This position dates at least to 1962, when the International Fiscal Association reportedly passed a resolution to this effect concerning the then-nascent collective investment vehicle industry. See Ed and Bongaarts, The Taxation of Investment Funds in IFA Cahiers 1997 — Vol 82b (1997) at p29 §8.2. The same claim has been advanced for private equity and other non-CIV funds. See, e.g., Institutional Limited Partners Association letter to OECD Center for Tax Policy and Administration of 22 April 2016; and Managed Fund Association letter to OECD Center for Tax Policy and Administration of 22 April 2016 (both responding to discussion draft with non-CIV examples applying PPT; comments package available as of this writing at www.oecd.org/ctp/treaties/Non-CIV-Examples-Compilation-of-Comments.pdf.

[14] Contrast claims for tax treaty benefits with respect to dividend and interest WHT, which are imposed on a gross basis and so generally require only information disclosure, rather than a filed return.

[15] See OECD 2017 Model at C(1)-10. For an OECD description of CIVs, and distinguishing features of private equity and other non-CIVs, see OECD, The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles (2010), reprinted in OECD 2017 Model as R(24), esp. ¶4.

[16] See, e.g., "ILPA Private Fund Investing Principles v3.0," (2019) ilpa.org/ilpa-principles/. The logic for computing carry on pretax returns is strong where incremental tax is incurred only due to holding arrangements employed for investors in order to manage those investors' sensitivities (e.g., tax filing obligations). In such a case, the carry plan with no such sensitivities reasonably can argue that it should be able to access the investment without the special structuring arrangements and compute and receive its carried interest accordingly. The logic is less compelling where all fund investors (including carry plan) access an investment in the same way, although it arguably remains reasonable where carried interest is taken as a proportionate share of both cash and cash taxes included in the return calculation, if such taxes are creditable by carry plan participants.

[17] As a nomenclature aside, the OECD's work on harmful tax practices identifies low- or nil-rate regimes available to only to nonresidents or persons who do not operate in the domestic market as "ring-fenced" from domestic economy. See, e.g., OECD (1998), Harmful Tax Competition: An Emerging Global Issue (OECD 1998) at 27-28; OECD (2015), Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance — Action 5 Final Report (OECD 2015) ("BEPS Action 5 Final Report"), at 20 ¶15.

[18] See, e.g., BEPS Action 2 Final Report; Council Directive (EU) 2017/952 (**ATAD 2**).

[19] See OECD, Treaty Entitlement of non-CIV Funds (Public Discussion Draft) (24 March 2016) at ¶11.

[20] See OECD 2017 Model at Art. 1(2); BEPS Action 2 Final Report, Ch. 14.
Fiscal transparency determinations are not always straightforward and may rely on analogues, or on the application of various factors. See The Application of the OECD Model Tax Convention to Partnerships (1999), reprinted in OECD 2017 Model as R(15), at 5 ¶14. Accordingly, conclusions with a high degree of confidence may be elusive in some cases, even with all of the facts. See, e.g., *George Anson v. HMRC* (2015) UK SC 44 (UK fiscal transparency of US limited liability company determined case by case).

[21] However, the application of anti-deferral rules by an IHC owner's residence jurisdiction generally does not give rise to a concurrent taxing claim that limits source-jurisdiction taxing rights. See OECD, Double Taxation Conventions and the Use of Base Companies, reprinted in OECD 2017 Model as R(5), at 21 ¶58. The OECD's recommended solution to potential double taxation arising in such a case is generally a credit for tax actually paid. See BEPS Action 3 Final Report at ¶¶122-23.

[22] BEPS Action 6 Final Report at 17 ¶17. See also Double Taxation Conventions and the Use of Conduit Companies (1986), reprinted in OECD 2017 Model as R(6), at 4 ¶6 ("[W]here [an entity] situated in a treaty country is acting as a conduit for channeling income economically accruing to a person in another State who is thereby able to take advantage 'improperly' of the benefits provided by a tax treaty… This situation is often referred to as 'treaty shopping.' ").

[23] Double Taxation Conventions and the Use of Conduit Companies (1986), reprinted in OECD 2017 Model as R(6), at ¶7.

[23.1] Id.

[23.2] Id.

[24] See BEPS Action 6 Final Report at ¶14 ("The continued examination of [the broader question of the treaty entitlement of non-CIV funds] would also address two general concerns that governments have about granting treaty benefits with respect to non-CIVs: that non-CIVs may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits and that investors may defer recognition of income on which treaty benefits have been granted."). See also supra note 5 and accompanying text (secondary sheltering resulting from changes to the character of income).

[25] The threshold determination that a given entity or arrangement constitutes a "person" can be difficult under local law, particularly in the case of trusts, which are common in CIVs. See, e.g., The Granting of Treaty Benefits with respect to the Income of a CIV (2010), reprinted in OECD 2017 Model as R(24), at 9ff; OECD 2017 Model at C(1)-11 ¶24. In private equity, the issue of personhood tends to be considerably less common and generally does not figure prominently in fund design. This note does not discuss it further.

[26] See, e.g., BEPS Action 2 Final Report, Ch. 13 (Dual-Resident Entities). This note assumes, unless stated otherwise, that an entity is resident only where formed.

[27] See OECD 2017 Model at C(4)-5 ¶8.11. The apparent tension in treating tax-exempt organizations as residents has in part led to the claim that the residence concept's reach exceeds its grasp, and that payments themselves are the better object of analysis and treaty contract. See Wheeler, The Missing Keystone of Income Tax Treaties, 3 World Tax J. 247 (2011), 252.

[28] The probative value of a TRC as issued in most cases was questioned in the OECD's draft implementation package for the TRACE system. See OECD, Possible Improvements to the Procedures for Tax Relief for Cross-Border Investors (2009) at ¶¶30-37.

[29] See OECD 2017 Model at C(4)-6 ¶8.13.

[30] See Double Taxation Conventions and the Use of Conduit Companies (1986), reprinted in OECD 2017 Model as R(6), at ¶14; BEPS Action 6 Final Report at 17. Commentary on beneficial ownership is extensive. See, e.g., du Toit, Beneficial Ownership: The Enigma Storms Ahead, 75 Bull. Int'l Tax'n 11 (2021); du Toit, The Evolution of the Term "Beneficial Ownership" in Relation to International Taxation of the Past 45 Years, 64 Bull. Int'l Tax'n 10 (2010).

[31] See OECD 2017 Model at C(10)-5, ¶12.2. See also the OECD report that preceded the change, Restricting the Entitlement to Treaty Benefits (2002), reprinted in OECD 2017 Model as R(17). Common-law litigation of the term has not clarified far beyond specific facts. See, e.g., *Her Majesty the Queen v. Prévost Car*, 2009 FCA 57 (2009) (Canada re dividends); *Indofood Int'l Finance Ltd v. J.P. Morgan Chase Bank N.A.*, 2006 EWCA Civ. 158 (2006) (UK re interest in back-to-back financing); du Toit, supra note 33; Raskolnikov, Contextual Analysis of Tax Ownership, 85 B.U.L. Rev. 431 (2005) (US approaches).

[32] BEPS Action 6 Final Report at page 19 ¶22. Although most OECD jurisdictions take the position that domestic anti-abuse provisions continue to operate unless a treaty specifically supersedes them, a minority considers a treaty as superseding all relevant domestic law except to the extent specifically reaffirmed in the treaty. See, e.g., Double Taxation and the Use of Base Companies (1986), reprinted in OECD 2017 Model as R(5), at R(5)-15 ¶40. See also OECD 2017 Model at C(1)-25 through -33.

[33] BEPS Action 6 Final Report at 18, ¶19.

[34] See OECD 2017 Model Preamble; OECD 2017 Model Art. 1 Commentary at ¶¶69, 76-80; OECD 2017 Model Art. 29 Commentary at C(29)-1 ¶1.

[35] OECD 2017 Model Art. 29 ¶9. A PPT may appear in domestic legislation outside of tax treaties. See, e.g., US Treas. Regs. §1.881-3 (conduit financing rules with PPT).

[36] See OECD 2017 Model at C(29)-90 ¶182.

[37] The OECD 2017 Model defines "equivalent beneficiary" in the CIV context essentially as a resident of a jurisdiction whose treaty with the source jurisdiction would grant that resident a rate at least as low as the rate claimed by the CIV with respect to the particular item of income if the resident had made the same investments directly rather than through the CIV. See OECD 2017 Model at C(1)-16 ¶35. The MLI defines equivalent beneficiary similarly in the context of the simplified LoB made available there. See infra notes 51-54 and accompanying text; MLI Art. 7(8)-(13). Although there are nuanced variations on the definition of an equivalent beneficiary (see, e.g., OECD 2017 Model at C(29)-60 to -74), they are not germane to the discussion in this note.

[38] See, e.g., EY letter dated 3 Feb 2017, reprinted in "BEPS Action 6 — Examples on Treaty Entitlement of Non-CIV Funds: Comments received on Public Discussion Draft: (03 February 2017)" at 85). Many other commenters requested the same or similar changes.

[39] As of 4 September 2023, only Andorra, Australia, Bahrain, Belgium, Côte d'Ivoire, Curaçao, Cyprus, Czech Republic, Fiji, Gabon, Guernsey, Hungary, Ireland, Isle of Man, Jersey, Lesotho, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Mongolia, Netherlands, New Zealand, Papua New Guinea, San Marino, Senegal, Seychelles, Singapore, Ukraine, United Arab Emirates, United Kingdom and Uruguay have elected. Refer to MLI at Art. 7(17)(b) and "matching" database available at www.oecd.org/tax/treaties/mli-matching-database.htm.

Anecdotally, we see some TAs agreeing settlements with this kind of analysis, regardless of MLI election. See also infra note 54 and accompanying text (history of derivative benefits in US LoBs), infra note 51 and accompanying text ("simplified LoB" in the MLI), and infra note 62 and accompanying text (proportional benefits for CIVs).

[40] Anti-abuse frameworks may apply substance-over-form analyses that definitionally recast facts to reflect a narrative about economic reality, or they may limit recasting to disregard of the abusive technique. See, e.g., *Gregory v. Helvering*, 293 US 465 (1935) (common-law substance over form); Halifax and Others (C-255-02) ECR 2006 I-01609, ECLI:EU:C:2006:121 ("Where an abusive practice has been found to exist, the transactions involved must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice."); Part IVA of the Income Tax Assessment Act 1936 (Australia's general anti-avoidance rule); Income Tax Act §245(5) (in Canada's general anti-avoidance rule); and US Treas. Regs. §1.881-3(a)(1) (disregarding conduit financing entities). But see, e.g., US IRC §269 (PPT disallowing corporate claims to deductions, credits and other allowances without disregarding corporation); *Comm'r v. Danielson*, 378 F.2d 771 (3d Cir., 1967) (government not bound by taxpayer claim of substance over form). See also infra Section 5 (potential analysis of disregarding an SPV under PPT).

[41] See OECD, Action Plan on Base Erosion and Profit Shifting (2013), at 13-14.

[42] See OECD, Harmful Tax Competition: An Emerging Global Issue (1998) at ¶¶79, 81.

[43] See OECD, Harmful Tax Competition: An Emerging Global Issue (1998) at ¶¶166-167; Appendix A to this note, summarizing certain OECD projects; BEPS Action 5 Final Report at 23 ¶¶23-24, 40 ¶88.

A variety of holding company/fund type regimes include specific requirements for employees, premises and activity in order to qualify for those regimes. The earliest codification of substance in this way appears to have been the 2004 Dutch decrees concerning finance companies, issued in response to the OECD's Harmful Tax project. See IFZ2004/126M (decree) and /127M (Q+A regarding application). Current Dutch substance rules that apply in a variety of contexts are extensive and include minimum payroll and premises requirements.

Outside the EU, see, e.g., the Section 13R/Section 13X regimes under the Singapore Income Tax Act (minimum employee and payroll requirements inter alia).

[44] See, e.g., BEPS Action 3 Final Report at §4.2.2, ¶¶ 81-86 (CFC rules); BEPS Action 5 Final Report, Ch. 4 (evaluating preferential tax regimes).

[45] See Report 14313/99 at ¶47.

[46] 2021/0434 (CNS), at 20 ¶13 (unrebutted presumption of insubstantiality should preclude application of residence jurisdiction double taxation agreements). See also infra text accompanying notes 79-80 (further discussion of ATAD 3).

[47] See, e.g., New York State Bar Ass'n, Report #1331: Proposed Revisions to the Limitation on Benefits Article of the US Model Tax Convention (16 November, 2015), at 20 ("[T]he traditional US view of treaty abuse has been directed at treaty shopping. Substance and protecting tax revenue was not [sic] the traditional function of the LOB Article, and the concerns of the OECD as expressed in the Action 6 Report are not traditional concerns of the United States in the treaty context.").

[48] See OECD, BEPS Action 6 — Discussion Draft on non-CIV Examples (6 January–3 February 2017) at ¶3 (exclusion of detailed LoB from MLI). As of 13 July 2023, the simplified LoB has been elected by Argentina, Armenia, Chile, Colombia, India, Kazakhstan, Kenya, Mexico, Namibia, Russia, Senegal, Slovak Republic and Uruguay. Refer to MLI at Art. 7(17)(c), and "matching" database at www.oecd.org/tax/treaties/mli-matching-database.htm.

[49] See, e.g., description of the earliest US LoB in Treasury Technical Explanation to US-Jamaica tax treaty (1981) Art 17 ("Article 17… assures that [sic] source basis benefits granted by a Contracting State pursuant to the Convention go to the intended beneficiaries — the residents of the other Contracting State — and not to residents of third States not having a substantial business and tax nexus with the other Contracting State."). For an overview of antecedents to modern LoBs, see Rosenbloom, Tax Treaty Abuse: Policy and Issues, 15 Law & Pol'y Int'l Bus. 763 (1981), 779-797.

[50] See Double Taxation Conventions and the Use of Conduit Companies (1986), reprinted in OECD 2017 Model as R(6), 17-18 (substantial activity; listed company; "alternative relief" that evolved into derivative benefits).

[51] See, e.g., Rosenbloom, Tax Treaty Abuse: Policy and Issues, 15 Law Int'l Pol'y Bus. 763 (1983), 826-7; Rosenbloom, Derivative Benefits: Emerging US Tax Policy, 22 Intertax 83 (1994).

The protocol to the 1981 US-Jamaica treaty reportedly contemplated ownership by equivalent beneficiaries as a safe harbor under a general facts-and-circumstances test. See Rosenbloom, Tax Treaty Abuse: Policy and Issues, 15 Law Int'l Pol'y Bus. 763 (1983), 826.

The US career of derivative benefits provisions appears to have started in a 1981 Discussion Draft of the US Model Income Tax Convention, seen its first explicit implementation in the 1992 US-Netherlands and US-Mexico treaties, and finally become part of the US Model in 2016. See Freud, Treaty Shopping and the 1981 United States Treasury Draft Model Income Tax Treaty, 6 Hastings Int'l and Comp. L. Rev. 627 (1983), 648; Rosenbloom, Tax Treaty Abuse: Policy and Issues, 15 Law & Pol'y Int'l Bus. 763 (1983), 826-7; United States Model Income Tax Convention (2016), Art. 22 ¶4.

It may be noted that the US 2016 Model Convention limits the number of equivalent beneficiary owners comprising the relevant percentage to 7, whereas the simplified LoB in the MLI does not.

[52] For the four freedoms, see Consolidated Version of the Treaty Establishing European Community, July 6, 2016, 2016 O.J. (C 202) 67 (TFEU).

[53] Commentary on EU nondiscrimination as applied to LoBs became more widespread in the wake of the ECJ's 2002 decision regarding the application of so-called "open skies" agreements. For a small sample, see, e.g., Georg W. Kofler, European Taxation under an 'Open Sky': LoB Clauses in Tax Treaties between EU Members and the United States, 35 Tax Notes Int'l 45 (2004) at 63, 71; Ruth Mason, US Tax Treaty Policy and the European Court of Justice, 59 Tax L. Rev. 65 (2005); Mindy Herzfeld,

The EU's Other Smoking Gun, 84 Tax Notes Int'l 12 (Oct 3, 2016); BNA Portfolio 6855-1st: US Income Tax Treaties — The Limitation of Benefits Article, at IV.B.2.a.

The potential for discrimination increases where a state's treaty policy produces different withholding rates across treaties (e.g., as the United States does by seeking the lowest rates possible with each treaty partner), rather than uniform rates across treaties (e.g., as Canada does). See Rémi Gagnon, Traveling without a Destination: Post-BEPS Anti-Treaty-Shopping Rules and Non-CIV Funds in Canada and the US, 87 Tax Notes Int'l 975 (4 September 2017).

54 Neither the Treasury Technical Explanation nor the Joint Committee on Taxation Staff Explanation of the 1992 US-Netherlands treaty mentions EU nondiscrimination as a consideration informing the then-novel derivative benefits provision. See Treasury Department Technical Explanation of US-Netherlands income tax treaty, signed 18 December 1992, and the protocol amending the treaty, signed 12 October 1993, at discussion of Article 26; Joint Committee on Taxation Staff Explanation of Proposed Tax Treaty and Proposed Protocol between the US and the Kingdom of the Netherlands, JCS-15-93 (26 October 1993), at Section II.(1) and Section IV discussion of Treaty Article 26. Of course, EU nondiscrimination was irrelevant to the contemporaneous US-Mexico treaty.

55 See INFR2014(44233), MEMO-15-6006. The European Commission reportedly issued a statement in connection with its first anti-tax avoidance directive (EU 2016/1164 ("**ATAD I**")) that LoBs are detrimental to the single European market, and that the Commission prefers to combat treaty shopping with a PPT. Mindy Herzfeld, The EU's Other Smoking Gun, 84 Tax Notes Int'l 12 (3 October 2016). Although the statement does not appear to be available online currently, there appears to be some precedent for this position in a reported press release condemning bilateral open skies agreements. Kofler, European Taxation under an "Open Sky": LoB Clauses in Tax Treaties between the US and EU Member States, 35 Tax Notes Int'l 45 (2004) at note 84 (citing 20.11.2002 IP/02/1713).

The EU remedy for discrimination may include requiring a disqualified company's residence jurisdiction to pay compensatory damages to shareholders, and/or reformation or denunciation of a provision or agreement. See Kofler, European Taxation under an "Open Sky": LoB Clauses in Tax Treaties between the US and EU Member States, 35 Tax Notes Int'l 45 (2004), 55, 65-67. ECJ invalidation of a US LoB provision would only foreclose the EU member from applying the LoB to protect its own tax base, because the ECJ has no jurisdiction over the United States. See Kofler at 55; Mason, US Tax Treaty Policy and the European Court of Justice, 59 Tax L. Rev. 65 (2005), notes 178-179 and accompanying text.

56 See ec.europa.eu/atwork/applying-eu-law/infringements-proceedings/infringement_decisions/ (accessed 13 July 2023).

57 See, e.g., OECD, Commentaries to the Model Tax Convention on Income and on Capital 2003, Art. 1 para 20 (introducing LoB to Model commentary); BEPS Action 6 Final Report at 19 ¶21 (acknowledging need to adapt LoB rule to reflect constraints on individual States, including EU law); BEPS Action 3 Final Report at ¶¶19-22 (acknowledging potential for EU discrimination).

58 See The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles (2010), reprinted in OECD 2017 Model as R(24), at 18-19. The consultative group's report to the OECD is titled Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors on The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles (2009). For investor equivalence, see supra notes 13-15 and accompanying text.

59 OECD 2017 Model at C(29)-28 and -29 ¶¶60-61. See also The Granting of Treaty Benefits with Respect to the Income of a CIV, reprinted in the OECD 2017 Model as R(24), at ¶¶55-56 (discussing cliff rules and proportionate benefits rules); Scherleitner, Thoughts on the Potential Effects of the OECD/G20 BEPS Action Plan on Collective Investment Vehicles — Part II, 71 Bull. Int'l Tax. 98 (February 2017) (arguing that OECD 2017 Model can be read as allowing proportional benefits/look through for CIVs).

60 See The Granting of Treaty Benefits with Respect to the Income of a CIV, reprinted in the OECD 2017 Model as R(24), at 13 -14 ¶¶36-40; 21 ¶61.

61 See, e.g., The Granting of Treaty Benefits with Respect to the Income of a CIV, reprinted in the OECD 2017 Model as R(24), at 13 ¶36, 19-20 ¶¶58-59 (deferral), 20 ¶¶60-61 (incidence).

62 See OECD 2017 Model commentary at C(1)-18 ¶19.

63 See Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors on Possible Improvements to the Procedures for Tax Relief for Cross-Border Investors (2009) at ¶18.

64 For TRACE, see OECD, TRACE Implementation Package for the Adoption of the Authorized Intermediary System (January 2013). For the QI program, see US Treas. Regs. §1.1441-5(c)(2).

65 See TRACE Implementation Package for the Adoption of the Authorized Intermediary System (January 2013) at 4-5.

During the BEPS PPT discussion, industry proposed an incremental variation on TRACE that essentially renames the AI a Global Streamed Fund ("**GSF**") and makes the GSF country's TA the WHT collection and payment agent. See letter of Nigel Fleming and Joanna Cound of BlackRock to OECD of 22 April 2016, in the public comments responding to the OECD's Public Discussion Draft on the Treaty Entitlement of Non-CIV Funds (January–February 2016) (available at www.oecd.org/tax/public-comments-received-discussion-draft-treaty-entitlement-of-non-civ-funds.htm). The OECD summarized the GSF proposal in Public Discussion Draft: Treaty Entitlement of Non-CIV Funds (24 March 2016) at ¶¶22-30. The GSF concept has clear administrative benefits to industry but seems likely to face considerable political hurdles, particularly in source jurisdictions, as acknowledged in the original letter.

[66] See Council Directive 90/435/EEC of 23 July 1990, as subsequently amended by Council Directive 2003/123/EC of 22 December 2003. See also Equiom and Enka, C-6/16, EU:C:2017:641 (7 September 2017) at ¶20; T Danmark C-116/16 (opinion of 1 March 2018) at ¶36; Deister Holding C504-16, ECLI:EU:C:2017:1009 (20 December 2017) at ¶¶48-50.

[67] Council Directive 90/435/EEC of 23 July 1990 at Art. 2(b). Taxpayers ordinarily demonstrate residency by delivering a TRC. See supra notes 28-31 and accompanying text; T Danmark C-116/16 (1 March 2018) at ¶22.

The original ownership threshold was 25%, later reduced to 10%. See Council Directive 90/435/EEC of 23 July 1990 at Art. 3(1)(a); Council Directive 2003/123/EC of 22 December 2003 at Art 1(3). The ownership threshold reflects the commonly observed distinction between purely passive "portfolio investment" (<10%) and so-called "direct investment" (10% or more) viewed as having some meaningful influence. Some tax treaties incorporate the distinction as a lower dividend withholding rate for direct investment.

The EU PSD does not have a beneficial owner concept and does not incorporate OECD Model Tax Convention concepts or determinations, such as beneficial owner. See, e.g., T Danmark C-116/16 (opinion of 1 March 2018) at ¶¶84-85. In contrast, the EU Interest and Royalties Directive does include a beneficial owner concept. See Council Directive 2003/49/EC of 3 June 2003 at Art. 1(4)-(5).

[68] Council Directive 90/435/EEC of 23 July 1990, at Art. 1(2).

[69] Equiom and Enka, C-6/16, EU:C:2017:641 (7 September 2017), ¶30 and the case law cited therein.

[70] See, e.g., T Danmark C-116/16 (opinion of 1 March 2018) at ¶¶54-59, 115(3)-(4); Y Danmark C-117/16 (opinion of 1 March 2018) at ¶¶52-57.

[71] Equiom and Enka, C-6/16, EU:C:2017:641 (7 September 2017), at 74.

[72] See Deister Holding C-504/16, ECLI:EU:C:2017:1009 (20 December 2017) at ¶¶65-66, 100.

[73] See T Danmark, C-116/16 (opinion of 1 March 2018) at 77.

[74] Y Danmark, C-117/16 (opinion of 1 March 2018) at ¶70.

[75] See EU 2016/1164 Art. 6(1)-(2); supra Section 3.b (Selected Investment Manager Considerations — Investment Holding Arrangements).

[76] ATAD 3 Art. 6.

[77] ATAD 3 Arts. 11-12.

[78] See supra note 19 and accompanying text.

[79] See supra note 43 and accompanying text.

[80] See also supra note 42 and accompanying text (MLI option for discretionary relief based on extent of equivalent beneficiaries).

[81] United Nations Model Double Tax Convention between Developed and Developing Countries (2021), Introduction ¶3.

[81.1] See discussion supra notes 22-24 and accompanying text.

[82] Double Taxation Conventions and the Use of Base Companies (1986), reprinted in OECD 2017 Model as R(5); Double Taxation Conventions and the Use of Conduit Companies (1986), reprinted in the OECD 2017 Model as R(6).

[83] OECD, Tax Havens: Measures to Prevent Abuse by Taxpayers, in International Tax Avoidance and Evasion, Four Related Studies (1987). The volume's reports on base companies and conduit companies are reprinted in the 2017 OECD Model as R(5) and R(6), respectively. The fourth study concerned bank secrecy.

[84] See OECD, Harmful Tax Competition: An Emerging Global Issue (1998).

[85] See statement of US Secretary of the Treasury Paul O'Neill in 2001, available at: home.treasury.gov/news/press-releases/po366

[86] See BEPS Action 5 Final Report Ch. 2. See also, search.oecd.org/tax/transparency/who-we-are/history/

[87] Restricting the Entitlement to Treaty Benefits (2002), reprinted in OECD 2017 Model as R(17).

[88] Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors on The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles (2009). The OECD report incorporating the recommendations, The Granting of Treaty Benefits with respect to Income of Collective Investment Vehicles (2010), is reprinted in the OECD 2017 Model as R(24).

[89] Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors on Possible Improvements to Procedures for Tax Relief for Cross-Border Investors (2009). History of the TRACE group and related work at the OECD available at: www.oecd.org/tax/treaties/aboutthetracegroup.htm

[90] See TRACE Implementation Package for the Adoption of the Authorized Intermediary System (OECD 2012). The scheme is analogous to the US "withholding foreign partnership" and "qualified intermediary" schemes, see Treas. Regs. §1.1441-5(c)(2), albeit with both source and residence jurisdictions involved in verifying payee treaty eligibility.

[91] See TRACE Implementation Package for the Adoption of the Authorized Intermediary System (2012) at 9-10 ("[A CIV] will only be treated as an intermediary . . . if [it is] fiscally transparent . . . .").

[92] BEPS background available at www.oecd.org/tax/beps/about/#history.

[93] BEPS Action 6 Final Report at 15 ¶10, 16 ¶14.

[94] BEPS Action 6 Discussion Draft on non-CIV examples (2017); Comments Received on BEPS Action 6 – Examples

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