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By Electronic Delivery

29 March 2018

Oliver Oppliger
Federal Tax Administration
Eigerstrasse 65
3003 Berne, Switzerland

RE: *Supplemental Information from US CIVs to Establish US Tax Residence of CIV Investors*

Dear Oliver,

Many thanks to Pascal, Urs, Markus, and you for the very productive meeting with ICI Global[1] and the Association of Global Custodians regarding procedures by which US collective investment vehicles (CIVs) organized as regulated investment companies (RICs)[2] can receive treaty relief. More specifically, we discussed various non-third-party sources of reliable and verifiable shareholder tax residence information that could be provided to the Swiss Federal Tax Administration. The administrable procedures we discussed would complement those described in Pascal's letter dated 7 September 2017.

This letter provides further support for the suggestions that ICI Global advanced during the meeting. One proposal, as we discussed, would allow for certain investor information provided by intermediaries to be treated comparably to investor information provided by a proxy solicitation firm; this intermediary-generated investor information, like proxy-solicitation-firm-provided information, would be treated as being held "directly" by the fund for purposes of the procedures agreed in 2001.[3] A second discussed proposal would allow RICs to treat certain share classes held by

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[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US$30.0 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

[2] ICI's members manage total assets of US$22.5 trillion in the United States for more than 100 million US shareholders.

[3] Under these procedures, RICs receive full treaty benefits so long as at least 95% of the RIC shares are held by US persons. RICs may extrapolate the US tax residence of their investors from their directly held shares so long as at least

nominees as being held by the nominees' customers "directly" in the fund. The letter also includes for your consideration a draft model letter (Enclosure A) that a RIC could use to supplement a tax reclaim filing and explain how it determined the US tax residence of its investors.

To appreciate fully the rationale upon which this proposal is based, it may be helpful to review the organization, operation, and taxation of RICs. This review, we submit, illustrates why RICs are entitled to full treaty relief under the Swiss-US income tax treaty. Moreover, treaty entitlement for RICs is supported by the conclusions of the Organisation for Economic Co-operation and Development's (OECD's) 2009 CIV Report[4] and the Article 1 Commentary in the 2010 Update to the OECD Model Tax Convention.[5]

The Organization, Operation, and Taxation of RICs

RICs are Widely Held Investment Vehicles

RICs are widely held, hold a diversified portfolio of securities, and are subject to stringent regulation under the Investment Company Act of 1940[6] and other US securities laws.[7] RICs typically have thousands of individual investors; some have hundreds of thousands. While the number of shareholder accounts in any one RIC is large, the size of the typical RIC account is relatively modest.[8] The amount of tax at issue for the average investor in a RIC that invests globally is considerably less. The cost to an individual RIC investor who sought to recover his or her proportionate interest in any excess tax withheld by a single country would be prohibitive.

RICs are Owned Almost Exclusively by US Persons

RICs, for both domestic and foreign tax and securities law reasons, are owned predominantly (if not exclusively) by US persons. The tax considerations discussed below generally make RICs non-competitive with non-US CIVs for non-US investors. The securities law considerations limit further any non-US investment in RICs. Finally, the US anti-money laundering rules and the difficulty of applying CIP (Customer Identification Program) requirements to non-US persons also limit non-US investment in RICs.

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half of all shares are held directly on the books of the RIC. The correspondence regarding this 2001 procedure is included as an enclosure to the enclosed letter dated 17 June 2016 (Enclosure B).

[4] The CIV Report more precisely is entitled "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" and is available on the OECD's website at www.oecd.org/tax/treaties/45359261.pdf.

[5] http://www.oecd.org/tax/treaties/45689328.pdf.

[6] 15 United States Code (U.S.C.) §§ 80a-1 *et seq.*

[7] *See,* the Investment Advisers Act of 1940 (15 U.S.C. §§ 80b-1 *et seq.*), the Securities Act of 1933 (15 U.S.C. §§ 77a *et seq.),* and the Securities Exchange Act of 1934 (15 U.S.C. §§ 78a *et seq.*).

[8] The most recent ICI data show median mutual fund assets of $125,000 per household in four accounts. https://www.ici.org/pdf/2017_factbook.pdf, Figure 6.2.

RICs are subject to relatively unique domestic tax treatment that generally makes them unattractive to non-US taxpayers. Specifically, while non-US CIVs often retain ("roll up") their income without incurring any CIV-level tax, RICs effectively are required by US tax law to distribute essentially all of their income in the calendar year in which it is earned.[9] Thus, a non-US taxpayer will incur residence-country tax on all RIC distributions (as ordinary income from corporate dividends). If the non-US investor instead acquires interests in a non-US CIV, residence-country tax often will be deferred until the interests are sold (at which point preferential capital gains rates may apply).

Non-resident investors also incur US withholding tax on dividend income[10] received from their RICs because the US treats all RIC dividends as having a US source. Thus, a non-resident investor in a RIC will incur US tax on dividends attributable to the RIC's non-US investments (*e.g.,* equities issued by Swiss companies); no US tax would be incurred, in contrast, if the non-resident investor purchased shares of a comparable non-US CIV that made the same non-US investments.

Foreign securities law considerations also limit foreign investment in RICs. To ensure that a RIC is not treated as making a "public offering" in a foreign country, and thereby subjecting the RIC to foreign securities laws (some of which may conflict with US requirements), most RICs state in their offering documents that their shares may be purchased only within the United States. These RICs' broker distribution agreements include the same restrictions. These restrictions are so stringent that many RICs will refuse to allow any investor who moves from the US to another country to reinvest RIC dividends in additional RIC shares.

Distribution of RIC Shares

RICs are distributed directly and through financial intermediaries (FIs). Shares purchased directly from the RIC are registered on the RIC's transfer agent's books in the name of the purchaser. Shares purchased through an intermediary may be registered in the name of the purchaser or, more commonly, in the name of the FI holding the shares in a "street name" or "nominee" account. FIs historically established street name accounts to prevent the firms managing RICs, as potential competitors, from receiving highly sensitive and proprietary information regarding the identities of the FI's clients.[11] Over the past several years, as explained below, many FIs have modified how information regarding their street name accounts is maintained.

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[9] These rules are contained in Subchapter M (26 U.S.C. §§ 851 *et seq.*) and/or in section 4982 of the Internal Revenue Code.

[10] Under Code section 871(k), if a RIC elects to "flow-through" the character of interest income and short-term gains distributed as a dividend, a non-resident RIC shareholder will receive these amounts without incurring any US tax.

[11] This competitiveness consideration, the OECD has recognized, is not limited to RICs. Indeed, one of the primary drivers for the OECD's Treaty Relief and Compliance Enhancement (TRACE) project is a difficulty confronting custodian banks. Specifically, the banks have difficulty securing the necessary treaty-eligibility documentation from competing financial intermediaries in the chain of holders between the custodian filing the tax refund claims and the underlying securities owners who were treaty-entitled. *See* http://www.oecd.org/ctp/exchange-of-tax-information/TRACE_Implementation_Package_Website.pdf.

Information Regarding the Identities of Investors in Brokers' Nominee Accounts

RICs typically will have complete customer-identity information (*e.g.,* name, residential address, US taxpayer identification number) only for those investors who purchase their shares directly from the RIC. For many RICs, the percentage of directly-held shares will be relatively low.

When shares are purchased through an FI, the FI must comply with the applicable know-your-customer (KYC)/Customer Identification Program (CIP)/anti-money-laundering (AML) requirements; the FI will secure IRS Forms W-9 from US persons and comply with all applicable US tax reporting and withholding requirements. For the competitive/proprietary reasons discussed above, FIs generally do not provide the RICs with complete customer-identity information (and many FIs do not provide RICs with any information regarding the FIs' customers).

Nevertheless, some customer-identity information collected by FIs may be made available to RICs to assist in detecting investors' short-term trading strategies such as market timing.[12] The SEC's Rule 22c-2[13] allows RICs to impose a redemption fee of up to two percent to recoup for the costs incurred by the RIC from these strategies. Under the Rule, RICs generally must enter into written agreements with FIs holding nominee accounts that require the FIs to provide the RICs, upon request, with certain shareholder identity and transaction information.

One way in which RICs and FIs may comply with their Rule 22c-2 obligations is to participate in a voluntary data-sharing file transfer system called Omni/SERV. The Omni/SERV files include a common matrix of data fields and a "pipeline" through which FI data regarding customers and their transactions is inputted and made available to the RICs in which the FI's customers invest.[14]

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[12] Market timing, as described by the SEC in footnote 4 of the Final Rule on Mutual Fund Redemption Fees, "includes (a) frequent buying and selling of shares of the same fund or (b) buying or selling fund shares in order to exploit inefficiencies in fund pricing. Market timing . . . can harm other fund shareholders because (a) it can dilute the value of their shares, if the market timer is exploiting pricing inefficiencies, (b) it can disrupt the management of the fund's investment portfolio, and (c) it can cause the targeted fund to incur costs borne by other shareholders to accommodate the market timer's frequent buying and selling of shares." SEC Final Rule on Mutual Fund Redemption Fees, 17 CFR Part 270 [Release No. IC-26782; File No. S7-11-04]. https://www.sec.gov/rules/final/ic-26782.pdf.

Short-term market timing in overseas mutual funds, as we discussed during the meeting, involves "time zone arbitrage." This strategy seeks to exploit US market valuation rules that typically determine the price of a RIC's shares at 4:00 pm (US East Coast time) based on the closing prices of foreign securities (such as those in the Asian securities markets); note, for example, that 4:00 pm in New York generally is 9:00 pm in London, 10:00 pm in Zurich, 6:00 am the next day in Tokyo and 8:00 am the next day in Sydney. The longer the foreign market has been closed, and the more significant the price-positive, post-market-close event, the more likely that an investor could profit substantially by purchasing RIC shares before 4:00 pm (US East Coast time) and redeem those shares the next day (when the RIC shares reflect the price increase attributable to the known price-positive, post-market-close event). *See* https://www.ici.org/pubs/faqs/faqs_timing.

[13] https://www.sec.gov/rules/final/ic-26782.pdf.

[14] Omni/SERV includes two types of files for sharing information regarding an FI's customers. The "position file" shows the amount a customer has invested in the RIC; the position file, more specifically, provides share balances as of a current date. The "activity file" provides information regarding purchases and sales of RIC shares by each customer; the activity file typically shows, among other things, the date, type, and dollar amount of each transaction.

Omni/SERV was sponsored by members of the ICI's Broker/Dealer Advisory Committee, in partnership with major FI's, their recordkeeping service providers, and the National Securities Clearing Corporation (NSCC), a wholly-owned subsidiary of The Depository Trust and Clearing Corporation (DTCC). DTCC, which is the US securities industry's "utility" for maintaining and trading individual securities, maintains Omni/SERV.[15]

Omni/SERV provides data for each investor account that is contained within a participating FI's nominee account for each RIC. Because firms participating in Omni/SERV often also utilize other complementary mechanisms for satisfying their Rule 22c-2 obligations, not all firms provide information for each Omni/SERV file data element. Typically, however, the data elements provided by an FI will include customer's TIN, residential address, zip (postal) code, and/or country code.

The Use of Share Classes for Certain Investor Types

RICs typically are offered to investors through various "share classes." Typical share class distinctions involve either the type of investor (such as individual or institutional) or the type of compensation arrangement for a financial adviser who provided services to the investor.[16] Many share classes are offered both directly to investors and to FIs holding in nominee accounts.

Different RICs will have different requirements for what constitutes an eligible institution for different institutional share classes. Some institutional share classes may be generally available to all institutions while others may be available only to specific types of institutions (such as employer-sponsored retirement plans, such as so-called "401(k) plans"). Eligible institutions for an institutional class may include corporations, bank or trust companies, foundations, charitable organizations, and retirement plans.[17]

Many RICs, for example, offer "R" (for retirement) shares to retirement plans. A RIC may have one class of R shares or multiple R shares classes; multiple R share classes often are offered to meet varying customer needs including the level of support provided to the plan administrator.

Because only specified types of investors may purchase specific types of institutional shares, a RIC will have some information about the investors in an institutional share class. All shares held in an "R" class, for example, will be held (directly or indirectly) by eligible retirement plans regulated

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[15] More information regarding Omni/SERV can be found at http://www.dtcc.com/wealth-management-services/mutual-fund-services/omni-serv.

[16] Different "load share" classes, for example, offer investors different ways to compensate their financial advisers for services provided (such as investment advice on which RICs to purchase). Some load share classes involve a large up-front payment and a small ongoing payment; other classes involve a back-loaded payment or a "level" payment. These distinctions, although not relevant to the proposal, are mentioned because data regarding them are referenced in the cite below to data for institutional share classes.

[17] At the end of 2016, the total net assets of US mutual funds (a form of RIC) that invest "long term" in equities and bonds totaled $13.616 trillion. Of the $9.093 trillion of net assets in "no-load" shares, almost half ($4.207 trillion) were invested in institutional share classes. $1.637 trillion of institutional shares was held by insurance companies in variable annuities and $514 billion was held by retirement plans in "R" shares. *See* https://www.ici.org/pdf/2017_factbook.pdf, Figure 5.13.

under US laws and, in general, available only to US residents.[18] If shares of a particular "institutional" class may be purchased only by eligible charities and foundations, for example, the RIC will know that no foreign individuals are included in the share class total.

Proposed Methods by Which RICs Can Establish the US Tax Residence of Their Investors

Our proposal addresses only the methods by which a RIC can establish that 95 percent or more of its shares are held by US residents—which allows the RIC to receive full treaty relief. [19] Pursuant to the July 2001 resolution of an earlier treaty-entitlement dispute[20] (as modified), if 50 percent or more of a RIC's shares are held "directly" ("the 50 percent threshold"), the RIC effectively can satisfy the 95 percent test based upon the "directly-held shares."[21]

More specifically, we propose that RICs should be able to treat shares held by nominees as "directly-held shares," for 50 percent threshold purposes, in prescribed situations in which residence status can reasonably be inferred from reliable factors. This proposal is appropriate, we submit, because RICs are the classic example of a domestically-offered, income-distributing CIV that should be treated as the beneficial owner of its income.[22]

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[18] Because the tax benefit of contributing to a US retirement account is limited to persons with US tax liabilities, the only non-US residents with a tax incentive to contribute would be US citizens living abroad and persons, such as students, who are temporarily in the United States on a visa that prevents them from being treated as US residents. As noted above, however, foreign "public offering" rules generally dissuade RICs from permitting purchases by US citizens living abroad. Moreover, the account balance of anyone temporarily in the United States would be small because (i) there are annual contribution limits and (ii) anyone temporarily in the United States would not make contributions over any extended period.

[19] Our proposal is limited as such because we understand that you agree that RICs are persons and US residents. The US Treasury's Technical Explanation of the current double tax convention between the US and Switzerland provides, for example, that certain entities that" are nominally subject to tax but that in practice rarely pay tax also would generally be treated as residents and therefore accorded treaty benefits. For example, RICs, REITs and REMICs are all residents of the United States for purposes of the treaty." *See* https://www.irs.gov/pub/irs-trty/swistech.pdf, page 11.

[20] The 10 July 2001 letter from the FTA's Eric Hess to the ICI's Swiss counsel is enclosed as Enclosure C; an unofficial English-language translation is enclosed as Enclosure D.

[21] The ICI agreed to this procedure (which initially did not include the 50 percent threshold) because the directly-held shares of most RICs were at least 99% owned by US persons. Thus, in effect, Switzerland maintained its position that RICs were transparent, while the RICs recovered 100% of the treaty relief claimed under administrable procedures.

[22] The 2000 agreement notes that the ICI and with Swiss government agreed to disagree on this legal issue because Switzerland implemented administrable procedures by which RICs could receive full treaty relief. Subsequently, as noted above, the OECD considered CIV treaty eligibility. As noted in paragraph 6.30 of the Commentary on Article 1 of the 2010 OECD Model Tax Convention (identical to paragraph 44 of the Commentary on Article 1 of the 2017 OECD Model Tax Convention), "in many countries the CIV industry is largely domestic, with an overwhelming percentage of investors resident in the country in which the CIV is established. In some cases, tax rules discourage foreign investment by imposing a withholding tax on distributions, or securities laws may severely restrict offerings to non-residents. Governments should consider whether these or other circumstances provide adequate protection against investment by non-treaty-eligible residents of third countries. It may be appropriate, for example, to assume that a CIV is owned by residents of the State in which it is established if the CIV has limited distribution of its shares or units to the State in which the CIV is established". Paragraphs 6.14 and 6.31 of the Commentary on Article 1 of the 2010 OECD Model Tax Convention (identical to paragraphs 28 and 45 of the Commentary on Article 1 of the 2017 OECD Model Tax Convention), as noted in the ICI's June 2016 letter, provide further support for this relief.

Importantly, this proposal would supplement the procedure "based upon third-party-collected information (*e.g.,* from a proxy solicitation firm)" that is described in Pascal's 7 September 2017 letter. As we discussed, the more routes that a RIC can take to establish the US tax residence of its investors, the lower the cost of treaty recovery and the higher the after-tax return of investing in Swiss securities.

We recognize that allowing multiple methodologies for establishing that shares held by nominees should be treated as "directly held" creates the potential for "double counting" if a RIC relied upon both "broker collected" and "share class" information. Any RIC seeking to establish treaty eligibility using more than one methodology would be required to explain how double counting was prevented. For example, a RIC utilizing shareholder information extracted from Omni/SERVE would need to explain that any shareholder information based upon share classes was derived only from street name shares that were not included in the Omni/SERVE-generated information.

Reliance upon Broker-Collected Information Supplied for US Regulatory Purposes

We propose that RICs be permitted to treat as directly-held shares for 50 percent threshold purposes those shares held by nominees for which sufficiently reliable shareholder tax residence information can be extracted from Omni/SERV reporting or a comparable shareholder recordkeeping system or reporting mechanism. RICs would be required to explain, in writing, the proportion of nominee shares for which FIs submitted data, the regulatory requirements applicable to the records, and the proportion of the files for which sufficiently reliable shareholder residence information was obtained.

For this purpose, we also propose that RICs be permitted to treat as US residents all shares for which an FI has populated in its shareholder recordkeeping system (including information shared with the RIC via Omni/SERV) with one or more of the following criteria: a US mailing address, a US country code, a US tax identification number (TIN), or an IRS Form 1099 (US person) tax reporting code. Although these fields may not be necessary to identify an individual for a specific regulatory purpose (such as Rule 22c-2), the information comes directly from FI records that are required for all US regulatory purposes. Thus, the data should be deemed sufficiently reliable (particularly given the tax and securities law reasons, discussed above, why RICs are owned almost exclusively by US persons).

We recognize that US citizens living abroad (who would have a US TIN and receive IRS Form 1099s) are not US residents for treaty purposes. The percentage of US citizens living abroad, however, is *de minimis* (estimated by the US government at less than 2.7%).[23] Moreover, because of the restrictions that RICs place on selling shares only in the US, the percentage of RIC shareholders living abroad most likely is considerably lower (probably well under one percent).

To illustrate our proposal, assume that 20 percent of the RIC shares are held directly and that the remaining 80 percent are held in nominee accounts. Also assume that, of the ten FIs holding the

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[23] The US Census Bureau estimates the US population at over 326.4 million. https://www.census.gov/popclock/. The State Department estimates that 9 million US citizens live abroad. https://travel.state.gov/content/dam/travel/CA_By_the_Numbers.pdf. So, of the 335+ million persons who are US residents and/or US citizens, less than 2.7% (9/335) are US citizens living abroad.

RIC's shares in street name accounts, nine of them (holding 85 percent of the street name shares) participated in Omni/SERV. Finally, assume that all of the Omni/SERVE records include information establishing tax residence. In our example, 68 percent of the RIC's total shares (85 percent of the 80 percent of the RIC's total shares that are held in street name) would be treated as directly-held shares; adding these shares to the 20 percent that in fact are registered directly with the RIC, 88 percent of the RIC shares (well above the 50 percent threshold) would be treated as directly-held. Assuming that 95 percent or more of these shares were held by US residents, the RIC would be entitled to full treaty relief.

Our proposal, we submit, would streamline the tax reclaim process for those RICs that participate in Omni/SERV (or a comparable shareholder data sharing mechanism). Because RICs would have immediate access to the data, they would not need to engage a third party (such as a proxy solicitation firm) that would need to collect data before a report could be prepared. The cost savings, which flow directly to the RICs' shareholders, could be substantial.

Nothing in our proposal would preclude RICs from establishing treaty eligibility by engaging a third party. Some RICs might take this route because they do not participate in Omni/SERV, because their primary FIs do not participate in Omni/SERV, and/or because they view the third-party route as most efficient.

Reliance upon Nominee Positions in Specified Share Classes

We also propose that RICs be permitted to treat as directly-held shares for 50 percent threshold purposes those shares held by nominees that are in a share class containing restrictions that effectively limit ownership to US residents. As over 30 percent of all RIC shares in "long-term" funds are held in institutional accounts,[24] treating appropriately-documented institutional shares held by nominees as "directly-held" could help RICs meet the 50 percent threshold.

Because RICs have different types of share classes and different eligibility requirements for each share class, RICs would be required to satisfy the FTA that US residents were the owners of the institutional class shares. Consequently, we would expect that RICs seeking to include these shares as "directly-held" would provide the FTA with offering documents or related materials for each relevant institutional class (such as "R" shares) that would support the treaty eligibility assertion.

Draft Model Letter for RICs Seeking to Apply This Proposal

We also enclose for your consideration a draft model letter that a RIC would provide the FTA to support a treaty refund claim based upon these proposals and the previously agreed procedures. Each RIC obviously would modify the letter to reflect the basis (or bases) upon which it treats as "directly-held shares" for the 50 percent threshold shares held by FIs. The basis could be that the information is reflected in FI-generated shareholder recordkeeping systems (and shared with the RIC via Omni/SERV) and/or that the shares are held in an "approved" institutional class. Each RIC would need to explain the justification (*e.g.,* shares are "R" shares or have a US TIN) for treating these shares as being held by the FI as a nominee for US residents. Importantly, as

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[24] As noted in footnote 17 above, $4.207 trillion of the $13.616 trillion invested "long term" in equity and bond funds at the end of 2016 was held in institutional share classes. *See* https://www.ici.org/pdf/2017_factbook.pdf, Figure 5.13.

explained above, each RIC would be required to explain how it prevented shares held by nominees from being "double-counted."

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Please do not hesitate to contact me at your convenience (1-202-326-5832 or lawson@ici.org) if I can provide you with any additional information. You also may contact our counsel at Baker & McKenzie LLP – Professor René Matteotti (+41 44 384 13 60 or Rene.Matteotti@bakermckenzie.com) or Mary Bennett (+1-202-452-7045 or mary.bennett@bakermckenzie.com).

Sincerely,

/s/ Keith Lawson

Keith Lawson
Deputy General Counsel – Tax Law

Enclosures

cc: Pascal Duss (Ministry of Finance)
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