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Achim Pross
Head, International Co-operation and Tax Administration Division
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development

RE : BEPS Action 2, Hybrid Arrangements, and Collective Investment Vehicles

Dear Achim,

The Investment Company Institute (ICI)[1] and ICI Global[2] urge that the Base Erosion and Profit Shifting (BEPS) Action 2 Public Discussion Drafts[3] be revised, as discussed below, to clarify the application of their recommendations to collective investment vehicles (CIVs). The only CIVs addressed by our recommendations are those that are widely-held, diversified, and subject to investor-protection regulation in the country in which the CIV is established; these CIVs invest over US$30 trillion[4] globally for their investors. We do not propose that our recommendations apply to private equity funds, hedge funds, or other types of investment vehicles.

We recommend changes to the discussion drafts for both treaty issues and domestic law recommendations. The draft on treaty issues, as discussed in detail below, should reference both the

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[1] ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds ("ETFs"), and unit investment trusts ("UITs"). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $16.8 trillion and serve over 90 million shareholders.

[2] ICI Global is a global fund trade organization based in London; members include regulated U.S. and non-U.S. based funds publicly offered to investors in jurisdictions worldwide. ICI Global seeks to advance the common interests and to promote public understanding of global investment funds, their managers, and investors. Members of ICI Global manage total assets of $1.4 trillion in non-U.S. funds.

[3] http://www.oecd.org/ctp/aggressive/hybrid-mismatch-arrangements-discussion-draft-domestic-laws-recommendations-march-2014.pdf; http://www.oecd.org/ctp/treaties/hybrid-mismatch-arrangements-discussion-draft-treaty-issues-march-2014.pdf.

[4] http://www.ici.org/research/stats/worldwide/ww_12_13.

CIV report that was adopted by the OECD's Committee on Fiscal Affairs (CFA) in 2010[5] and the Treaty Relief And Compliance Enhancement (TRACE) Implementation Package (TRACE IP) that was approved by the CFA in 2013.[6]

The draft on recommendations for domestics law should provide relief for CIVs to avoid implicating legitimate financial transactions routinely engaged in by CIVs. Specifically, the recommendations should provide that (i) a CIV will be treated as a related party in a hybrid mismatch transaction only if it has actual knowledge that the requisite ownership test for related party status has been met; (ii) CIVs never will be treated as acting in concert merely because the CIVs are offered by the same investment manager, unless the CIVs have an agreement to purchase the same security in some coordinated fashion; (iii) the related party ownership threshold is increased to at least 25%; (iv) a CIV is treated as engaged in a structured arrangement only if it has actual knowledge, based on interaction with the counterparty, that the counterparty is receiving a tax benefit that outweighs the potential investment benefits to the CIV; and (v) repurchase agreements (repos) and securities lending transactions, which often constitute legitimate transactions, are not categorically characterized as hybrid mismatch transactions subject to the proposed rules.

Our recommendations are limited to the CIVs described above because these CIVs – widely-held, diversified, and regulated – have been analyzed extensively the OECD and an Informal Consultative Group it organized in 2006. The result of this examination, as mentioned above, was the CIV Report; this report discussed in detail the organization and operation of CIVs and made specific recommendations for providing treaty relief to CIVs and/or their investors.

One factor relevant to both the CIV Report and BEPS Action 2 is that, since CIVs typically calculate every day a net asset value (NAV) that is the basis for subscriptions in and redemptions of the CIV's interests, certainty regarding income and tax liability/expense is of paramount importance.

Support for OECD's BEPS Initiative

As noted in our prior submission on BEPS Action 6 and tax treaty abuse (attached), we support the OECD's role in addressing on a coordinated basis various important tax concerns. We also recognize that hybrid mismatch arrangements can be a serious problem for Governments. In our view, however, CIVs almost never (if ever) would be involved in the types of transactions against which BEPS Action 2 hybrid arrangement recommendations should be directed.

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[5] 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. *See also,* http://www.oecd.org/tax/treaties/45689328.pdf (the 2010 Update to the OECD Model Tax Convention Article 1 Commentary, in which the CIV Report's recommendations were incorporated).

[6] http://www.oecd.org/ctp/exchange-of-tax-information/TRACE_Implementation_Package_Website.pdf.

Background

CIVs – In General

A CIV is a pooled investment vehicle for providing investors with diversification and professional management. CIVs are organized as separate investment pools (often, but not always, as separate legal entities) that are owned by their respective investors. All the administrative services for the CIV are performed by a management company or another service provider. Each CIV has a specific investment objective discussed prominently in its prospectus.

A management company typically will establish multiple CIVs to achieve different investment objectives. The management company employs portfolio managers (PMs), analysts, research assistants, etc., to select portfolio securities and engage in specific transactions that are appropriate for each specific CIV. Management companies often have different arrangements for how their CIVs' portfolios are managed. Possible variations include the following: a specific CIV may have one or more PMs; one person might be a PM or analyst for more than one CIV; and/or analysts and research assistants may follow specific securities for an entire complex or provide portfolio assistance to specific CIVs.

CIV Portfolio Management

The PM is responsible for making the day-to-day investment decisions for the CIV. The PM's investment decisions are guided by a fiduciary duty to the CIV's investors. Portfolio selection and transaction decisions must be consistent with that CIV's investment objectives and appropriate relative to other securities in that CIV's portfolio. CIVs typically do not invest to obtain control of a company. Domestic diversification laws typically limit a CIV's ability to own a controlling interest in a company.

The PM makes investment decisions based upon what is best for that CIV's investors. Even if the PM manages more than one CIV, the decision of whether to invest in a security is made independently for each CIV. CIVs may have different investment objectives and will hold different securities and engage in different transactions.

The PM does not buy a security or engage in a specific transaction because another portfolio manager has done so. If the management company has research indicating that a security is undervalued, each PM will decide independently whether that security provides a better value than the other securities in the CIV's portfolio. Securities are not purchased because of investment decisions made on behalf of other CIVs.

CIV Structures

CIVs are structured in different organizational forms depending on local laws, cost efficiencies, and distribution arrangements. Every CIV, regardless of organizational form, operates as an investment vehicle distinct from every other vehicle.

Many CIVs are organized as stand-alone investment vehicles. Even in this simple CIV formulation, however, there are variations. Some CIVs are organized solely for distribution purposes. In this so-called "master-feeder structure," the "master" fund is the CIV in which all portfolio securities are held. The only investors in the master fund will be other CIVs (known as "feeder" funds) that are offered to investors. One benefit of the master-feeder structure is that a small financial institution can offer "its own" CIV to its customers without actually managing a CIV portfolio (which is done at the master fund level). Each feeder fund effectively is a separate pooled investor in the master fund.

Another typical CIV organizational form is the so-called "umbrella fund" or "series fund" structure. The structure is used widely because of the many organizational and operational conveniences that reduce costs and benefit investors. This structure consists of multiple "sub-funds" (the term used in Europe, among other places) or "series" (the term used in the United States) in a single fund structure. Investors acquire interests in one or more sub-funds based upon their desire for the investment objective of each such sub-fund. Each sub-fund is a separate investment vehicle (although it may not be a separate legal entity). In the United States, for example, each individual CIV that is part of a series fund is treated as a separate person for U.S. tax purposes.

Distribution of CIV Interests

Most CIVs in most markets rely heavily on intermediaries for the distribution of their CIV interests. In most countries, it is quite common for CIV interests to be registered on the CIV's books in the name of a distributor or a central securities depository (CSD). The CIV itself may know the identity of some of its investors. Because of the proprietary nature of the customer relationship, however, the distributor often will not share the individual investor's identity with other distributors or with the CIV itself.

The typical retail CIV will have thousands of shareholders; some CIVs will have hundreds of thousands of shareholders. CIV investors may hold their interests directly with the CIV's transfer agent. More commonly, the interests are held through an intermediary that often holds the interests in a nominee (omnibus) account. CIVs may have hundreds or thousands of intermediary distributors that hold the CIV interests for their customers.

Nominee accounts include so-called "street name" accounts set up by brokerage firms, banks, and financial planners for their customers, those held on "platforms" that are utilized by these firms, and those set up by so-called "fund supermarkets," which are created by financial services firms to invest their clients' assets in other firms' CIVs. Nominees may hold for other nominees; financial planners can hold their clients' assets in an account with another nominee, such as a fund supermarket, that will be the shareholder of record at the CIV level.

Treaty Issues

BEPS Action 2 Public Discussion Draft (Treaty Issues) proposes two additions to the Commentary to Article 1 of the OECD Model Tax Convention that are particularly concerning to CIVs. These additions are summarized immediately below and explained subsequently in greater detail.

Our first concern is with paragraph 26.5's statement that the Partnership Report conclusions extend to "situations that were not directly covered by the Report." This statement fails to acknowledge the conclusions reached subsequently in the CIV Report. Because the treatment of CIVs has been addressed in detail, we suggest that the phrase "(other than those involving CIVs)" be inserted between "situations" and "that are not directly covered by the Report."

Our second concern is with paragraph 26.6's statement that, if a State cannot verify whether a person is truly entitled to treaty relief, the State "might well decide to use the refund mechanism . . . even though it normally apples these benefits at the time of the payment of the relevant income." This statement fails to acknowledge the conclusions reached subsequently and reflected in the TRACE IP. Because TRACE provides Governments with assurances that treaty claims are valid and reduces the costs otherwise imposed on both Governments and business with a reclaim system, we suggest that a sentence indicating the benefits to Governments of adopting TRACE be inserted after the sentence beginning, "Also, as recognised in the Report." The penultimate sentence of this paragraph then could begin with the phrase, "If a Contracting State nevertheless cannot obtain tax information about an entity, that State . . . ."

CIV Report

The CIV Report was a direct result of the work done by the OECD on the Partnership Report. Specifically, an awareness arose that other vehicles, such as trusts and CIVs, presented issues in some ways similar to those raised by partnerships. This fact specifically was mentioned, during the Working Party 1 consultation with business on 17 February 2005, as the catalyst for the meeting's discussion of CIV treaty eligibility issues and the subsequent, extensive work on CIVs.

The CIV Report, as discussed in detail in our 8 April 2014 comments on BEPS Action 6, was the product of a multi-year consultation between Governments and business. The consideration given by the Partnership Report to transparent vehicles informed the CIV deliberations. Hence, there is no need, in the BEPS Action 2 context, to "extend" the Partnership Report's conclusions to CIVs. The Report's considerations already have been extended to the extent applicable.

We submit, therefore, that the CIV Report and the changes made to the Article 1 Commentary balance appropriately all relevant treaty considerations. The CIV Report's thoughtful approach for applying an LOB clause to CIVs should be reflected expressly in the Final Report on BEPS Action 6. One approach for doing so would be to insert into paragraph 26.5 the phrase "(other than those involving CIVs)" between "situations" and "that were not directly covered by the Report." A footnote to this paragraph, similar to the one that we understand will be included in the BEPS Action 6 Final Report, would direct the reader to the CIV Report and the additional language regarding CIVs that will be added to the Commentary pursuant to the BEPS Action 2 initiative.

TRACE Implementation Package

The TRACE IP was a second-generation by-product of the Partnership Report. More specifically, the TRACE IP was the product of the analysis that began with CIVs and was extended to other situations in which information regarding the identity of a security's underlying owners historically has not been shared with the source country. The reason that this customer identity information has not been shared is that it is held by an intermediary; the intermediary (such as a custodial bank or a securities dealer) treats the customer's identity as proprietary (commercial) information too valuable to share with other intermediaries in the payment chain between the source country and the underlying owners.

TRACE addresses this situation, as explained in detail in the Report finalized in 2009 by the ICG organized by the OECD,[7] by allowing intermediaries to enter into legal relationships with a source country. Under TRACE, financial intermediaries make treaty claims based upon "pooled information" about treaty eligibility that rely upon information about the treaty eligibility of an intermediary's customers. The customer identity detail is provided to the source country, rather than to the CIV or to another intermediary in the payment chain, pursuant to the arrangement between the source country and the intermediary.

The ICI, ICI Global, and our members strongly support TRACE because it provides for at-source treaty relief which we submit is important to providing the certainty that CIVs require to calculate their NAVs and price their interests every day. We remain keenly interested in prompt and broad adoption of the TRACE IP.

Importantly, TRACE also provides substantial other benefits to governments, business, investors, and markets. At-source treaty relief and simplified procedures for providing governments with necessary assurances that treaty relief claims are appropriate will reduce costs for all. Compliance responsibilities will be shifted to financial institutions subject to well-developed safeguards; these institutions are in the best position, from an access and knowledge standpoint, to ensure the accuracy of investor information. Governments also will benefit from TRACE because investors will receive the withholding tax relief provided by negotiated treaties; as a result, these investors will not claim foreign tax credits (to the detriment of their residence governments) for excess tax that they cannot recover. Streamlined withholding procedures also will make local markets more attractive to cross-border investment.

We submit, therefore, that the Commentary to the proposed new paragraph 2 of Article 1 of the Model Tax Convention discuss the benefits to source countries of investor certainty that are available through broad adoption of the TRACE IP. As noted above, we suggest that a sentence indicating the benefits to Governments of adopting TRACE be inserted in paragraph 26.6 after the sentence beginning, "Also, as recognised in the Report . . . ." The new sentence, for example, could state that "Adoption of the

[7] http://www.oecd.org/ctp/treaties/41974569.pdf.

TRACE Implementation Package will allow Contracting States to receive the necessary verifications." The penultimate sentence in paragraph 26.6 then could be revised to begin with the phrase, "If a Contracting State nevertheless cannot obtain tax information about an entity, that State . . . ."

Domestic Law Issues

The BEPS Action 2 Public Discussion Draft (Recommendations for Domestic Laws) section on hybrid financial instruments and transfers raises three significant concerns for CIVs. Addressing fully our concerns will help prevent the BEPS Action 2 Final Report from having unintended negative consequences for the capital markets.

First, strict application of the "related persons" and "acting in concert" rules that are proposed in the Public Discussion Draft would inadvertently implicate routine investments by CIVs. These transactions do not give rise to the policy concerns that BEPS Action 2 is intended to address. Application of these rules, however, would have detrimental effects on CIVs and their abilities to manage their portfolios effectively.

To address these concerns, as discussed in detail below, we urge the following modifications to BEPS Action 2. First, we urge that the proposal treat a CIV as a related party engaged in a hybrid mismatch transaction only if the CIV has actual knowledge that the requisite ownership test for related party status has been met. Second, we urge that CIVs never should be treated as acting in concert merely because the CIVs are offered by the same manager. The acting in concert standard should be met only if the CIVs have an agreement to purchase the same security in some coordinated fashion. Finally, the minimum threshold interest for related party status should be raised from 10% to at least 25%.

Second, we have the same concerns that strict application of the "structured arrangement" readily identifiable factors would have detrimental effects on CIVs. In particular, we are concerned about the "pricing" factor and the "tax-indifferent accommodation party" factor. The price at which an instrument trades, almost by definition, reflects all factors (including tax) that affect the investment return. Moreover, a CIV owned exclusively by tax-exempt investors (such as pension funds) might be considered "tax-indifferent." We urge clarification that CIVs will be treated as engaged in a structured arrangement only if they have actual knowledge, based upon interaction with their counterparty, that the counterparty is enjoying a tax benefit from the transaction that outweighs the potential investment benefits to the CIV of the transaction.

Finally, the Public Discussion Draft suggests that cross-border repurchase agreements ("repos") and securities lending arrangements are inappropriately tax-motivated. CIVs, as discussed below, enter into these transactions for legitimate investment or hedging purposes. Repos and securities lending are not *prima facie* aggressive tax planning transactions. One of the reasons that we support a bottoms-up approach to hybrid transactions is that CIVs generally will be effectively exempted from hybrid treatment with respect to their legitimate use of these arrangements, so long as transactions that are readily available in the commercial markets are not treated as ones in which parties are treated as acting in concert to take advantage of hybrid mismatches.

Related Persons and Acting in Concert

We urge, as noted above, that the "related persons" and "acting in concert" rules be modified before the BEPS Action 2 Final Report is issued. The rules proposed in the Public Discussion Draft would inadvertently implicate routine investments by CIVs even though these transactions do not give rise to the policy concerns that BEPS Action 2 is intended to address.

First, the proposed rules should treat a CIV as a related party engaged in a hybrid transaction only if the CIV has actual knowledge that the requisite ownership test for related party status has been met. Because many CIV investors hold their shares through an intermediary, as discussed above, the CIV likely will not know the identity of a substantial portion of its investors. Therefore, the CIV will not have sufficient information to determine that it is "related" to the counterparty under the proposed definition. Requiring CIVs to collect or analyze information about their investors and/or the other investments held by these investors is impossible as a practical matter. Moreover, requiring CIVs to disclose their portfolio holdings on a current basis, so that the CIVs' investors or the issuers of the CIVs' portfolio investments could determine whether a related party situation existed would be equally problematic. If others were informed of a CIV's investments, they could trade on that information to the detriment of the CIV and its investors.

Under the proposed rules, it is possible that a CIV unknowingly could enter into a routine financial transaction with an institutional investor that, under this proposal, is a related party, thus causing the transaction to qualify as a hybrid financial instrument or transfer. The institutional investor itself likely will not know that the parties are related. Because these transactions are entered into by the parties for legitimate non-tax reasons, they should not be implicated by the proposed rules simply because the CIV and the counterparty have unknowingly become related persons. Therefore, CIVs should be exempt from the hybrid mismatch rules, except in the unlikely case of structured transactions where the CIV has actual knowledge that the counterparty is a related person.

It is also important to note that in the "master-feeder" structure, for example, one CIV may hold as much as 100% of another CIV. Although the related funds would not engage in financial transactions with one another, it is possible that transactions by either fund with a third party could fall within the related persons rule, especially given the low threshold for determining ownership. The complex organizational structures would make tracking of such relationships across a fund complex incredibly burdensome. Providing an exception to the related persons rule for CIVs without actual knowledge of a relationship would resolve this problem.

Second, we urge that CIVs never should be treated as acting in concert merely because the CIVs are offered by the same manager. The "acting in concert" standard should be met only if the CIVs have an agreement to purchase the same security in some coordinated fashion.

Paragraph 128 notes that parties that have entered into "shareholders or voting agreements, joint venture and private equity funds under the control of a common manager all raise relationship issues" similar to those raised by related parties. The proposed rule provides that two persons will be treated as acting together in respect of ownership or control of any voting rights or equity interests if, among other things, the ownership or control of any such rights or interests is managed by the same person or group of persons. This definition could apply to CIVs offered by the same investment management company. Though the investment manager may not have any equity interests in the CIVs, the investment manager does "manage" the investments held by the CIVs. If these CIVs are deemed to be related persons, equity interests held by one CIV could be aggregated with those held by the other CIV, causing the CIVs to be "related" to a common issuer. Thus, any transactions entered into by either one of the CIVs with the common issuer could be deemed hybrid financial transactions.

CIVs offered by the same investment management company should not be deemed to be acting in concert under this proposal. As discussed above, the CIVs have different PMs with separate fiduciary duties and investment objectives. The CIVs' purchases in common issuers will not be coordinated or aimed at a particular tax outcome. Requiring CIVs to assess the holdings of other CIVs with the same investment manager before entering into financial transactions would be incredibly burdensome and provide little, if any, benefit. Therefore, the proposal clearly should carve out from the "acting in concert" rule CIVs with a common investment management company, unless it is clear that the funds truly are taking coordinated action.

Finally, the minimum threshold interest for related party status should be raised from 10% to at least 25%. The Public Discussion Draft recognizes, in paragraph 127, that funds may have investors with ownership interests that exceed 10% but believes these "non-portfolio investors" should be sufficiently aware of their ownership interest to comply with the hybrid mismatch rules.

In general, CIVs do not have many investors with more than a 10% ownership interest. This does not mean, however, that such investors do not exist. There are numerous situations in which a particular investor may hold an interest that is greater than 10%. For example, daily redemptions may decrease the size of a CIV, causing an existing investor's percentage ownership interest to increase. Also, a newly formed fund may have investors with larger interests (including "seed money" contributed by the investment management company to allow the CIV to begin operations). The mere fact that an investor holds an interest of 10% or more does not create a significant relationship between the investor and the CIV. For the investor, particularly if it is an institutional investor, the stake in the CIV may be relatively small in comparison to the investor's entire portfolio.

We believe that a higher threshold should be used to determine whether parties are related. We submit that a threshold of at least 25% is more likely to capture the types of transactions about which the OECD is concerned without overly burdening CIVs and their portfolio investors.

Financial transactions entered into by CIVs typically do not give rise to the concerns raised in the BEPS Action Plan. Therefore, CIVs generally should be excluded from the proposed rules on hybrid mismatches; they should be included *only* when a CIV has actual knowledge that it is party to a structured transaction with a related person. If, however, the OECD still is concerned about hybrid mismatches in the context of CIVs, we submit that it consider the United States rules addressing the extent to which related entity rules might be applied to CIVs. Specifically, U.S. Treasury Regulations, in the context of rules that limit losses when there is an ownership change involving "5-percent shareholders," define an "entity" to include "a group of persons who have a formal or informal understanding among themselves to make a coordinated acquisition of stock. A principal element in determining if such an understanding exists is whether the investment decision of each member of a group is based upon the investment decision of one or more other members."[8]

It is clear from the examples in the Treasury regulations that clients acting on a recommendation of an investment advisor are not making a coordinated acquisition because each client's decision was not based upon the investment decision made by one or more other clients. The result is no different if the trustee of several trusts causes each trust to purchase a company's stock, so long as the investment decision made on behalf of each trust was not based on the investment decision made on behalf of one or more of the other trusts.

The examples in the Treasury regulations have been extended in Internal Revenue Service private letter rulings to situations involving CIVs. Specifically, the rulings provide that two or more CIVs will not constitute an entity within the meaning of the regulations merely because: (a) the same corporation acts as investment manager to the CIVs; (b) the same corporation votes the securities purchased on behalf of the CIVs; and/or (c) the CIVs have the same board of directors. This guidance should be applied as well to the definition of related entity in BEPS Action 2.

Any other result could disrupt the capital markets. Issuers should be concerned that their otherwise-appropriate interest deductions could be limited if CIVs organized by the same investment management company hold 10% or more of the issuer. In addition, the operational challenge of tracking ownership by multiple CIVs would be extremely difficult. Aggregation would make no sense, we submit, if one CIV is buying while the other is selling. Aggregation also would be inappropriate if the CIVs acquired their interests at substantially different times.

The purpose of each independent acquisition of a security is to benefit from the income arising from the security and/or appreciation in the security's value. So long as there is no plan, aggregation is inappropriate. The substantial burden of developing systems to aggregate the holdings of different CIVs is justified only if the PMs are acting in concert.

Structured Arrangements

The discussion of structured arrangements also raises concerns regarding financial transactions routinely engaged in by CIVs. Paragraph 131 lists five factors that could be considered in determining whether an arrangement is "structured." These include (i) whether the pricing of the arrangement took in account sharing of the tax benefit or the expected tax benefit of a hybrid mismatch; and (ii) whether the arrangement involves tax-indifferent accommodation parties or special purpose vehicles. The Public Discussion Draft notes that the list of indicators is being explored further.

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[8] Treasury Regulations §1.382-3(a).

The use of these two factors, alone or together, to determine whether a structured arrangement exists are troublesome for CIVs, as they may be present in many legitimate transactions utilized by CIVs. We understand the desire for a comprehensive objective test but ask the OECD to consider the implications for transactions that do not raise BEPS concerns. For instance, looking at whether the pricing of the arrangement reflects any tax benefit to either party may not effectively eliminate transactions that should not be included in the hybrid mismatch rules. The price at which an instrument trades, almost by definition, reflects all factors, including tax, that affect the investment return. Thus, this factor is overly broad and could draw in transactions that are effected for legitimate non-tax reasons. Requiring CIVs to apply the hybrid mismatch rules could have a chilling effect on their ability to invest in the capital markets.

Further, considering whether a transaction involves a "tax-indifferent" party could implicate a CIV owned exclusively by tax-exempt investors, such as pension funds. These CIVs, like all other CIVs, enter into various financial transactions for legitimate investment purposes; the fact that the CIV's investors are not subject to tax in their home country should not be considered alone in determining whether a transaction is a structured arrangement. The possibility that the participation of a CIV with tax-exempt investors could cause a transaction to be deemed a structured arrangement could inhibit these CIVs' abilities to invest in the markets, disadvantaging their investors.

It is highly unlikely that a CIV would enter into a true structured arrangement. The indicators set forth in the Public Discussion Draft, however, could cause legitimate transactions by CIVs to be deemed "structured arrangements" under the hybrid mismatch rules, even though these transactions do not give rise to the tax policy concerns addressed by BEPS Action 2. Given the possible detrimental effect of applying these factors in the CIV context, CIVs should be treated as engaged in a structured arrangement only if they have actual knowledge, based upon interaction with their counterparty, that the counterparty is enjoying a tax benefit from the transaction that outweighs the potential investment benefits to the CIV of the transaction.

Repos and Securities Lending

The Public Discussion Draft specifically identifies repos and securities lending transactions as hybrid financial transactions that can result in a mismatch in tax outcomes, lowering the aggregate tax burden for the parties to the arrangement. Although there certainly are examples of repos and securities lending transactions that do so, such transactions are not *prima facie* aggressive tax planning techniques. Moreover, repos and securities lending transactions are important sources of liquidity for the markets. Consequently, they should not be treated as *prima facie* aggressive tax planning techniques in the BEPS Action 2 Final Report.

CIVs routinely enter into repos and securities lending transactions for legitimate, non-tax purposes. For example, CIVs use repos as a cash management tool. As such, they often enter into repos at the end of the day to receive a return on any excess cash. If there is a concern regarding the use of cross-border repos, the solution is for domestic law to treat the transaction in accordance with its substance – which is a secured financing – rather than as a sale. CIVs also often enter into securities lending transactions, pursuant to which a fund loans its securities to other parties, to increase the return on those securities. Applying the proposed hybrid mismatch rules to these transactions could inhibit CIVs' abilities to effectively manage their portfolios.

Given the many important market-beneficial non-tax reasons for using repos and securities lending transactions, the BEPS Action 2 Final Report should state clearly that such transactions are not *prima facie* structured transactions that give rise to mismatches in income. The Final Report also should clarify that the hybrid mismatch rules apply only when the repo or securities lending transaction is specifically structured to take advantage of any hybrid tax treatment. Transactions that are readily available in the commercial market should not be subject to the proposed rules.

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These issues are critically important to the global CIV industry. Our recommendations, we submit, are fully consistent with sound tax policy.

Please feel free to contact us (at lawson@ici.org or 001-202-326-5832 or at kgibian@ici.org or 001-202-371-5432) at your convenience if you would like to discuss this issue further or if we can provide you with any additional information.

Sincerely,

/s/ Keith Lawson

Keith Lawson
Senior Counsel – Tax Law

/s/ Karen L. Gibian

Karen Gibian
Associate Counsel – Tax Law

Attachment

cc: Kate Ramm
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