

Taxation of  
Collective  
Investment  
Funds and  
Availability of  
Treaty Benefits

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## TAXATION OF COLLECTIVE INVESTMENT FUNDS AND AVAILABILITY OF TREATY BENEFITS

### Introduction

Ireland has long been recognised as a destination of choice for investment funds. As an international fund domicile, Ireland ranks amongst the most flexible and advantageous in the onshore world due, in no small part, to the wide variety of investment fund vehicles that may be established under the Irish regulatory system. Ireland has in its favour: a developed national infrastructure, a highly competent and skilled workforce, political stability, a favourable regulatory system and, most importantly, a willingness on the part of the Irish regulatory and tax authorities, specifically the Central Bank of Ireland, the Irish Stock Exchange and the Irish Revenue Commissioners (IRC), to adapt and develop regulations to keep pace with international developments.

Between 2001 and 2009, Ireland increased its proportion of European cross-border assets by 367%, accounting for over 30% of the European cross-border market.<sup>1</sup> Undertakings for Collective Investment in Transferable Securities (commonly referred to as UCITS) account for 80% of Irish domiciled assets and Irish UCITS are distributed in over 60 countries worldwide.<sup>2</sup> As of October 2010, 4,763 Irish domiciled funds were in existence with an estimated net asset value of EUR 906,401 million. It is the fund domicile of choice for over 388 different fund promoters.

As such, the Irish funds industry plays an important role in the global investment funds market and supports initiatives to increase tax treaty access for collective investment vehicles (CIVs).

### Type of Taxation of Irish Funds

#### Investment Fund Types

Ireland's regulatory regime provides for the establishment of a wide variety of investment fund types (referred to herein as "fund" or "funds"). Fund categories can be broadly split between UCITS and non-UCITS funds.

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<sup>1</sup> Source: Lipper FMI, 2010, available at: [http://www.irishfunds.ie/content/marketing\\_collateral/why\\_ireland\\_the\\_facts\\_web.pdf](http://www.irishfunds.ie/content/marketing_collateral/why_ireland_the_facts_web.pdf).

<sup>2</sup> Source: Central Bank of Ireland, 2010 and analysis of Lipper data, 2010 (see note 1).

UCITS are the most common vehicle, as they can be sold in other Member States without a requirement for additional authorisation (the “European passport”). Ireland, however, also has non-UCITS funds, which include retail schemes, professional investor funds (PIFs) and qualifying investor funds (QIFs). The QIF regime is, by far, the most popular type of non-UCITS fund established in Ireland. QIFs are subject to a minimum subscription of EUR 100,000 and are only available to (1) an investor who is a professional client within the meaning of Annex II of Directive 2004/39/EC (Markets in Financial Instruments Directive, MiFID); (2) an investor who receives an appraisal from an EU credit institution, a MiFID firm or a UCITS management company that the investor has the appropriate expertise, experience and knowledge to adequately understand the investment in the QIF; or (3) an investor who certifies that s/he is an informed investor by providing confirmation regarding knowledge, expertise and understanding. The quid pro quo for these sales restrictions is that QIFs have no borrowing or leverage restrictions, virtually no investment restrictions and benefit from lighter touch regulation than other Irish regulated funds.

A QIF can be authorised by the Central Bank on a filing only basis. In practical terms, this means that once the QIF meets certain agreed parameters, including the requirement that the parties involved in the operation of the QIF meet certain criteria, the Central Bank does not review the fund's application. Provided the Central Bank receives a completed application for the authorisation of the QIF before 3:00 p.m. Irish time on a particular business day, the QIF will be authorised the following business day.

The Irish Central Bank requires that the QIF (or the Irish management company in respect of a unit trust) issue a prospectus (it may issue separate prospectuses in respect of cells or individual classes), which, together with the constitutional document and signed material contracts, must be submitted to the Central Bank by the QIF's legal advisers on the business day prior to the proposed authorisation date of the QIF. The QIF's legal advisers will also complete the Central Bank's application form. The application form requires certification from the QIF or its management company, as appropriate, in relation to the contents of the form and the documentation. The custodian of the QIF is required to provide confirmation in relation to the custody agreement.

## **Fund legal structures**

### *In General*

There are various structures that funds may take, from unit trusts to corporate funds, from investment limited partnerships to common contractual funds (CCFs). Although, from an administrative point of view, each vehicle functions in a similar way, with the value of its

shares/units/participations fluctuating in line with the value of its underlying assets, each vehicle is subject to different legislative provisions. The following provides a summary of each form.

#### *Corporate Funds*

A fund that is structured as a variable capital investment company may be established pursuant to (1) the UCITS Regulations or (2) the provisions of Part XIII of the Companies Act, 1990 (for non-UCITS vehicles). A fund that is structured as a variable capital investment company must be incorporated as a public limited company. Such corporate funds are incorporated entities with separate legal personality. They have the capacity to enter into contracts and to sue and be sued. Their day-to-day management and control is provided by a board of directors, with ultimate control resting with shareholders.

#### *Unit Trusts*

A unit trust may be established in Ireland pursuant to the Unit Trusts Act, 1990 (for non-UCITS vehicles) or pursuant to the UCITS Regulations. A unit trust is a fund vehicle created by written agreement between a manager and a trustee known as a trust deed. A unit trust does not have a separate legal existence, does not have the capacity to contract and cannot sue or be sued in its own name.

The assets of a unit trust are held by its trustee (in its capacity as custodian) and are managed by its manager who may appoint one or more investment managers/advisers. Contracts in relation to the management and administration of the trust fund are entered into by the manager, whereas the trustee enters into contracts in relation to the assets themselves, such as bank deposits, security agreements, etc.

#### *Investment Limited Partnership*

An investment limited partnership is a partnership between one or more general partners and one or more limited partners. The principal business of an investment limited partnership is expressed in the partnership agreement. It should be noted, however, that this type of structure is rarely used and can only be established as a non-UCITS fund.

#### *CCFs*

Another example of Ireland's innovative fund industry is the introduction of the CCF in 2003 to enable pension funds and trustees or custodians of pension funds to pool their

investments (asset pooling) in a tax efficient manner. Originally devised as a UCITS structure limited to pension funds (or trustees or custodians of such pension funds), the CCF was further enhanced in 2005 by the Investment Funds, Companies and Miscellaneous Provisions Act, 2005, which provided for the establishment of a non-UCITS CCF and allowed for the investor base to be expanded (essentially to include all pension funds, institutional investors and corporate entities).

A CCF is constituted under contract law by means of a deed of constitution executed under seal by a management company. The deed provides for the safekeeping of assets of the CCF by a custodian, who is also a party to the deed, and specifies the fiduciary responsibilities of the custodian that are equivalent to those of custodians of other UCITS and Non-UCITS schemes.

Importantly, the CCF is an unincorporated body and does not have legal personality. Because a CCF does not have legal personality, it may act only through the manager (or investment manager, if authority is delegated to an investment manager). Participants in the CCF hold their participation as co-owners and each participant holds an undivided co-ownership interest as “tenant in common” with other participants. The central rationale for establishing a CCF is the capacity to provide participants with a tax-transparent vehicle, where participants are treated as investing directly in the pool of assets, and which benefits from all of the advantages of investing via a pooled arrangement.

## **Taxation of Irish Investment Funds**

### *Fund Level Taxes*

The tax treatment of regulated funds in Ireland is one of the key reasons for the success of the Irish funds industry. Funds are not subject to any taxes on their income (profits) or gains arising on their underlying investments. While dividends, interest and capital gains that a fund receives with respect to its investments may be subject to taxes, including withholding taxes, in the countries in which the issuers of investments are located, these foreign withholding taxes may, nevertheless, be reduced or eliminated under Ireland’s network of tax treaties to the extent applicable (see section headed “Tax Treaty Benefits” below).

### *Subscription Tax*

No stamp duty (subscription tax) is payable in Ireland on the issue, transfer, repurchase, redemption, etc. of units/shares in a fund.

### *Value Added Tax (VAT)*

From a VAT point of view, the 2006 VAT Directive<sup>3</sup> provides an exemption applicable to the “management of special investment funds as defined by Member States”. There is no legal definition of this exemption; however, from an Irish VAT perspective, the VAT exemptions are wide-ranging with regard to the provision of services to funds (for example, fund administration, transfer agency and investment management). Indeed, the long-held view of the IRC with regard to various services was reinforced by the decision of the European Court of Justice (ECJ) in the *Abbey National* case<sup>4</sup> on the scope of the VAT exemption for management of special investment funds. The ECJ held that the VAT exemption for management of special investment funds may apply to services performed by a third-party manager in respect of investment management and the administrative management of the fund. This is consistent with other ECJ decisions on outsourcing in the financial services sector, such as *Sparekassernes Datacenter*<sup>5</sup> and *CSC Financial Services*<sup>6</sup> in that it is the nature of the service being provided that is crucial to its VAT treatment, not the characteristics of the person providing it. However, in order for the supply of outsourced management services of special investment funds to fall within the VAT exemption, the services supplied “must, viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions” of the exemption (i.e. management of the fund). The supply of IT services or other “mere material or technical supplies” does not fall within the exemption. This overturned the position of the Commission and the UK government that the supply by a third party of purely administrative services that did not include investment management did not fall within the exemption.

The provision of custodial (trustee) services to funds is also typically VAT exempt. While there is no exact statutory exemption from Irish VAT for custodial fees (unlike for management fees) the IRC have agreed the significant component parts of such a service are fundamentally VAT exempt and, while some of the component services provided by a fund custodian may be taxable, they typically constitute a negligible part of the total cost of supplying the custody service.

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<sup>3</sup> Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

<sup>4</sup> ECJ, 4 May 2006, Case C-169/04, *Abbey National plc* (with *Inscape Investments Ltd* as Joined Party) v. Commissioners of Customs and Excise.

<sup>5</sup> ECJ, 5 June 1997, Case C-2/95, *Sparekassernes Datacenter (SDC) v. Skatteministeriet*.

<sup>6</sup> ECJ, 13 December 2001, Case C-235/00, *Commissioners of Customs and Excise v. CSC Financial Services Ltd* (formerly *Continuum (Europe Ltd) Ltd*).

### *VAT Recovery*

Investment funds are generally seen as taxable persons from an Irish tax perspective. However, as they are not engaged in taxable supplies they are only required to register for VAT if they are liable to Irish VAT on the receipt of certain taxable services (for example, tax and legal services provided by suppliers established outside Ireland). In the specific case of unit trusts, the investment fund cannot obtain a VAT number. The VAT registration is undertaken by the management company.

Nevertheless, regardless of whether or not a fund is registered for Irish VAT, it can still offset/recover Irish VAT on the purchase of services from suppliers based on the relevant fund's input VAT recovery percentage.

### **Taxation of investors from the perspective of the investment funds**

#### *Non-Residents*

As outlined above, Irish investment funds are not subject to any taxes on their income (profits) or gains arising on their underlying investments. In addition, there are no Irish withholding taxes in respect of a distribution of payments by investment funds to investors or in relation to any encashment, redemption, cancellation or transfer of units in respect of investors who are neither Irish resident nor ordinarily resident in Ireland, provided the fund has satisfied and availed of certain equivalent measures or the investors have provided the fund with the appropriate relevant declaration of non-Irish residence.

The IRC, following lengthy negotiations with the Irish funds industry, introduced new measures into the 2010 Finance Act to amend the rules with regard to relevant declarations for non-residents. The position prior to this was that no tax would be imposed on a fund with regard to payments in respect of an investor who was neither Irish resident nor ordinarily resident in Ireland at the time of the payment, provided that an appropriate declaration was in place and the fund was not in possession of any information that would reasonably suggest that the information contained therein was no longer materially correct. In the absence of such a declaration there was a presumption that the investor was Irish resident or ordinarily resident in Ireland. The 2010 Finance Act contains measures that provide that the above exemption in respect of investors who are not Irish resident nor ordinarily resident in Ireland apply where appropriate equivalent measures are put in place by the fund to ensure that such shareholders are not Irish resident nor ordinarily resident in Ireland and the fund has received approval from the IRC in this regard.

## ***Irish Residents***

### *Exempt Investors*

Again, no Irish withholding taxes apply in respect of a distribution of payments by funds to such investors (which would include approved pension schemes, charities, other investment funds, etc.) or any encashment, redemption, cancellation or transfer of units in respect of investors that have provided the fund with the appropriate relevant declaration.

### *Non-Exempt Investors*

If an investor is Irish resident and not an exempt Irish investor, a 27% tax is required to be deducted by the fund on distributions (where payments are made annually or at more frequent intervals). A 30% tax will have to be deducted by the fund on any other distribution or gain arising to the investor on an encashment, redemption, etc. of units by an investor who is Irish resident or an ordinary resident in Ireland. While this tax will be a tax liability of the fund, it is effectively incurred by investors out of their investment proceeds. This tax component can prove useful when a fund is endeavouring to obtain treaty benefits (see sub-heading entitled “Is the Fund a Resident of Ireland” below).

### *Units/Shares held in a Recognised Clearing System*

Any payment to an investor or any encashment, redemption, cancellation or transfer of units/shares held in a recognised clearing system (as defined under Irish tax legislation) will not give rise to a chargeable event for the fund. The typical funds that fall within this category are Exchange Traded Funds. Thus, the fund will not have to deduct any Irish taxes on such payments regardless of whether they are held by investors who are Irish residents or ordinarily resident in Ireland, or whether a non-resident investor has made an appropriate relevant declaration. Nevertheless, investors who are Irish resident or ordinarily resident in Ireland, or who are not Irish resident or ordinarily resident in Ireland but whose units are attributable to a branch or agency in Ireland, may still be liable to account for Irish tax on a distribution or encashment, redemption or transfer of their units.



## Tax Treaty Benefits

### In General

The considerations in regard to tax treaty benefits for Irish regulated investment funds can be broken down into two areas. The first is theory and the second, practice, which was one of the driving forces behind the OECD Report, “The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles” released on 31 May 2010.

As readers may be aware, this OECD Report is a modified version of the Report, “The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles” of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors (ICG), which was released on 12 January 2009. In the original Report, the ICG addressed the legal and policy issues specific to Collective Investment Vehicles (CIVs) and formulated a comprehensive set of recommendations addressing the issues presented by CIVs in the cross border context. The OECD Committee on Fiscal Affairs (the “Committee”) referred the ICG’s recommendations to its subsidiary body responsible for changes to the OECD Model Tax Convention (OECD Model) for further consideration.<sup>7</sup> The Report was issued as a discussion draft on 9 December 2009, modified in response to public comments and morphed into the final draft of the OECD Report released by the Committee on 31 May 2010.

The OECD Report analysed the technical questions of whether a CIV should be considered a “person”, a “resident of a contracting state” and the “beneficial owner” of the income it receives under tax treaties that, like the OECD Model, do not include a specific provision dealing with CIVs (i.e. the vast majority of existing tax treaties). The OECD Report also contained proposed changes to the Commentary on the OECD Model in light of the aforementioned analysis, which were included in the Commentary to the 2010 update to the OECD Model (the “2010 Commentary”). Prior to that, no specific reference to the treatment of CIVs was contained in the OECD Model or Commentary.

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<sup>7</sup> OECD Releases Report on Granting of treaty benefits with respect to the Income of Collective Investment Vehicles. See [http://www.oecd.org/document/26/0,3343,en\\_2649\\_33747\\_45359706\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/26/0,3343,en_2649_33747_45359706_1_1_1_1,00.html).

## **An Analysis of Irish Funds in light of the Technical Questions raised in the OECD Report**

The question of treaty accessibility for Irish regulated investment funds has been a source of debate for the last 20 years and continues to be so.

In line with the commentary in the OECD Report, uncertainties arise in the context of the entitlement of Irish funds to benefit from reduced rates/exemptions under its tax treaties. In line with the OECD Report, an examination is provided herein of the issues surrounding Irish funds claiming tax treaty benefits in an Irish context. While the OECD Report concentrated specifically on CIVs that are widely held, hold a diversified portfolio of securities and are subject to investor protection regulation in the country in which they are established, the principles discussed are, in the authors' opinion, applicable to any Irish regulated fund (other than CCFs, which are tax-transparent) wishing to obtain treaty benefits.

### *Is a Fund a Person?*

As the OECD Report and the 2010 Commentary provide, the determination of whether or not a CIV is a person begins with the legal structure of the CIV. As outlined above, Ireland has a number of legal structures; however, by far the most commonly used are corporates and unit trusts. While there is no doubt that a CIV established as a company is a person for the purposes of a tax treaty, in practice, to the authors' knowledge, no countries have denied treaty benefits to Irish funds established in the form of trusts *solely* on the ground that the unit trust is not a person for treaty purposes. Indeed, in some cases, trusts are specifically included in the definition of a person (for example, the tax treaties with the United States and Canada).

### *Is the Fund a Resident of Ireland?*

In the authors' experience what creates the most debate, in practice, for Irish funds is the requirement to be a resident of a contracting state (i.e. Ireland). This is because the determination of whether or not a CIV is a "resident of a contracting state" depends not on its legal form (as long as it qualifies as a person) but, as the OECD Report provides, on its tax treatment in the contracting state in which it is established.

In general, tax treaties can be separated into two groups: (1) treaties including a residence clause that states that, for an entity to be a resident of the contracting state for the purposes of the tax treaty, the entity must be "any person who is resident in Ireland for the purposes of Irish tax" (a "tax residence" test) and (2) treaties containing a clause that provides that an

entity must be “any person who, under the laws of that State, is liable to tax therein” (a “liable to tax” test).

The criterion under (1) is obviously easier to satisfy and, for the most part, in relation to tax treaties that apply the tax residence test, Irish funds typically obtain treaty benefits.

With regard to (2), because of the way Irish funds are taxed (essentially no tax at the fund level if the investors are not resident in Ireland or if the investors are exempted Irish investors), some foreign tax authorities do not accept that Irish funds are liable to tax therein and consequently it is harder to satisfy this latter test as required by more recent tax treaties. The fact that, in the interpretation and application of the tax residency clause, the “liable to tax” requirement seems to have been very much underappreciated does not assist in this regard! In fact, despite the extensive tax treaty history and OECD guidance, the interpretation of the “liable to tax” requirement for entities included in Art. 4(1) of the OECD Model is ambiguous at best.

The interpretation of the “liable to tax” requirement appears to be prone to inconsistencies due to both the fact that there is little specific OECD guidance on this, as well as a tendency of some countries to interpret the “liable to tax” requirement as a “subject to tax” requirement.

Para. 8.6 of the 2010 Commentary on Art. 4 affirms that, “in many States, a person is considered liable to comprehensive taxation even if the Contracting State does not in fact impose tax”. It gives examples of pension funds, charities and other organisations that would, in principle, be liable to tax under their domestic laws, and only benefit from a “subject” exemption once they meet certain criteria for the exemption as set out in the legislation. Actual taxation is, therefore, not required, so long as such entities meet one of the criteria that would give rise to unlimited taxation in the absence of domestic relieving provisions.<sup>8</sup> The above position is supported by various states (for example, Canada) and also international case law suggests that tax-exempt entities can be considered “liable to tax” despite the fact that they are not “subject to tax”.

It is also useful that the OECD Report and the 2010 Commentary provide that the above analysis should apply to any entity that has satisfied the “person” requirement. Accordingly, for purposes of the residence test, the legal form of the CIV is relevant only to the extent that it affects the taxation of the CIV in the contracting state in which it is established. So, for

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<sup>8</sup> Margriet Lukkien, “The ‘Liable to tax’ requirement for qualification of entities as tax treaty residents”, International Bar Association – Legal Practice Division, *Taxes Newsletter*, October 2010, p. 10.

example, with respect to those countries that, for tax purposes, treat all CIVs in the same manner (such as Ireland) regardless of legal form, all CIVs established in that country should be treated as residents, or none of them should, for treaty purposes.

In practice, many Irish funds (including unit trusts) have been obtaining treaty benefits based on one or more of the following factors:

- (1) As outlined in 2, a withholding tax will arise on a distribution to an Irish resident investor (that is not an exempt investor). As this is a tax liability of the fund, this can be sufficient to support the position that the fund is liable to tax;
- (2) Under the general provisions of Irish tax law, Irish corporate tax generally applies to all companies that are resident in Ireland and, in particular, where they are resident under the management and control test (as opposed to the incorporation test). Therefore, a strong argument can be made that it is only because of the nature of a funds regulated activity and the nature of the permitted financial products in which the fund can invest that the fund is subject to a special regime pursuant to which, under current Irish law, the fund is not chargeable to Irish tax on its income or gains; and/or
- (3) Depending on the nature of the trust, similar arguments to those outlined in (2) above can be made for a unit trust (i.e. if it was not regulated, the trust itself or the trustees acting collectively in their capacity as such, would be treated as a taxpayer or person for domestic law purposes).

Nevertheless, Irish funds do not always obtain tax treaty benefits despite the above factors, which should not come as a major surprise bearing in mind that Para. 8.7 of the 2010 Commentary specifically notes that some countries take the view that an entity that is exempt from tax is not “liable to tax” within the meaning of Art. 4.

*Is the fund the “beneficial owner” of the income it receives?*

The Report recognizes that because the OECD Model does not provide a definition of “beneficial ownership”, this concept is mostly interpreted in accordance with the domestic laws of the respective contracting states. However, it is argued that a CIV that falls within the definition of the OECD Report (i.e. widely held, diversified portfolio, subject to investor protection regulation) should be treated as the beneficial owner of the income it receives. This position is subject to the assumptions that the investment manager of a CIV has discretionary powers to manage the assets of the CIV (on behalf of its investors) and the CIV

also meets the requirements that it be a “person” and a “resident” of the state in which it is established. Practical experience with respect to the denial of treaty benefits to Irish funds confirms this view and, indeed, for the reasons outlined in the OECD Report, it would be the exception to the rule that an Irish fund, and particularly corporate funds, would be denied treaty benefits because the relevant source country has taken the position that the fund cannot be the beneficial owner of the income that it receives.

### *CCFs*

As CCFs are specifically structured as tax transparent vehicles to facilitate direct access to tax treaty relief in the investor’s home country, they should not qualify as a resident of Ireland for purposes of tax treaties. Indeed, much of the work performed in relation to these structures is in obtaining the necessary confirmation in each territory of the tax transparency of the CCF from an investor and investment perspective. As a result, there should be no tax drag arising from the application of Irish withholding taxes, the character and source of the income or gains received by the CCF should not be “re-categorised” on distribution to participants and such income and gains should be subject to the same tax treatment in the hands of the participants as if received directly by them, rather than through the CCF (i.e. each investor should be in a position to benefit from “home country” tax benefits).

### **Position of the IRC**

Not surprisingly, the IRC’s position has evolved over the last 20 years, since the tax exemption for Irish funds was introduced. The IRC’s current position is helpful in assisting Irish funds to obtain treaty benefits and/or to benefit from an EU domestic tax exemption. Unlike Luxembourg, the IRC has not produced a list of treaty partners with which it has clarified whether Irish funds are entitled to treaty access or a list of countries in respect of which it believes Irish funds should be entitled to treaty benefits (based on the wording of the particular treaty). Instead, they have attempted to assist Irish funds in obtaining treaty benefits by issuing certificates of Irish tax residence to Irish funds that clearly state that the relevant fund is tax resident in Ireland for Irish tax purposes and thereby subject to Irish tax (albeit the IRC states that a special tax regime applies to such funds). They have helpfully taken the position (through such certificates of tax residence) that all Irish funds are “persons” resident in Ireland and subject to Irish tax. Of course the corresponding contracting state may not agree due to the special tax regime applicable but as a first step the IRC position is helpful.

## Procedures for Claiming Treaty Benefits

Not surprisingly, the practical aspects of obtaining treaty benefits are a factor to be considered. Treaty benefits can be granted at source or by way of a refund (on application) of the difference between the non-treaty rate and the treaty rate. Relief at source may impose an obligation on, for example, the payer to ensure that it is satisfied that the relevant fund is entitled to treaty benefits (or indeed, in the context of Member States, whether the relevant fund qualifies for a domestic exemption from withholding tax that may apply to payments made to persons in another Member State). Naturally, in that context, the payer needs to be comfortable that treaty benefits are available and, if in doubt, the non-treaty rate of withholding tax is deducted (forcing the relevant fund to seek a refund) or an indemnity is sought from the fund in the event that treaty benefits are not granted. Obviously, withholding tax refunds give the relevant treaty partner an opportunity to examine the correctness of the refund claim and, assuming such refunds are processed successfully, this should provide the fund (and perhaps custodians) comfort that the tax authorities of the relevant treaty country have implicitly agreed with the fund's entitlement to claim treaty benefits. It is the authors' experience that some custodians have taken different positions on the availability of treaty benefits to Irish funds, occasionally taking a position based on incorrect information as to the tax status of the relevant fund. Nevertheless, the position taken by custodians is another practical factor to be considered in determining the availability of treaty benefits to Irish funds.

## Tax Structuring

Where treaty access is important, there are structuring solutions that may be used to facilitate treaty benefit claims for certain investment funds. One such structure combines the favourable investment funds regime for QIFs with the favourable Irish securitisation regime (in respect of which Irish tax neutrality can effectively be achieved through the use of profit equalisation securities). Essentially, the fund finances the securitisation vehicle (SPV) (which will be a 100% subsidiary of the fund) by taking up a profit participating security issued by the SPV. The SPV then uses the monies raised through the issue of the profit participating security to purchase the investments (in the normal manner) as set out in the investment funds' policy documentation. As the SPV is a fully taxable vehicle in Ireland (albeit its taxable profits can be managed to a desired level including taxable profits of zero if so desired – through the use of profit participating securities) and the SPV is the entity making the investments, it typically removes one of the obstacles to tax-exempt regulated funds obtaining treaty benefits, namely the requirement to be “liable to tax”.

An additional benefit of this structure is that it should eliminate any chance of a foreign tax exposure for the fund as a result of being deemed resident and/or having a permanent establishment in another jurisdiction (where the investment manager is located) by the very reason that the Irish investing vehicle, the SPV, should clearly be liable to tax in Ireland and a resident thereof for purposes of the relevant treaty.

### **Irish position in relation to provisions in the 2010 OECD Commentary**

Finally, it is worth noting that, from the outset, the Irish funds industry welcomed the OECD's work in the area of treaty benefits for CIVs, the publication of these reports and their aim to provide clarity and consistency in the application of tax treaty access to internationally distributed investment funds, as well as the opportunity to participate in a consultative process. The industry agreed with the favoured approach of the ICG, which is now included as one of the alternative provisions that can be used by contracting states as a standard for inclusion in their income tax treaties to treat a CIV as a resident of a contracting state and the beneficial owner of its income, as this was seen as the most feasible way of achieving the objectives of the report in a timely and workable manner. The industry expressed concerns with respect to any option that would seek to limit entitlement to treaty benefits to residents of the same country in which the CIV is established, as that would, in the industry's opinion, leave investment funds sold on the international market at a significant competitive disadvantage in comparison to domestic investment funds and it would be unfair and regressive to place international investment funds at a competitive disadvantage by enabling countries to limit benefits to residents of the domicile of the fund. Nevertheless, the industry, in acknowledging the original discussions to link the granting of treaty benefits to CIVs with the residency of the underlying investors, did, in theory, support the option put forward by the ICG and included in the final OECD Report, pursuant to which a CIV would be entitled to benefits with respect to all of its income if "good investors" exceeded a specific ownership threshold (safe harbour threshold), where "good investors" would, for example, be determined based on the countries in which a fund is registered for sale.

## **Conclusions**

Not surprisingly, the ability of Irish funds to benefit from Ireland's network of tax treaties and/or to avail of an EU domestic exemption (for payments made between different Member States), so as to reduce or avoid foreign withholding taxes, is not free from doubt. However, there are good reasons why Irish funds (both corporate funds and unit trusts) should be able to access many of Ireland's tax treaties. The IRC have been supportive in that regard. In practice, many funds do obtain treaty benefits in the form of either relief at source or via

withholding tax refunds. The OECD Report is a welcome addition in that its attempt to bring some clarity to the issue or at least highlight the relevant points that need addressing. However, whether or not treaty benefits are available to Irish funds will continue, for the foreseeable future, to boil down to the views of the relevant contracting states to a particular tax treaty and the views of tax practitioners.

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