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By Electronic Delivery

2 December 2016

Division Head
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

RE: *CIV Non-Resident Withholding Taxes*

Dear Australian Treasury:

ICI Global,[1] on behalf of its collective investment vehicle (CIV) members, supports measures that simplify withholding tax obligations and minimize the burden imposed on non-residents investing in Australia. To maximize the pool of non-resident capital available to Australian companies (and the resulting benefits to the Australian economy), all CIVs should be eligible to benefit from any such measures. Equal opportunity for all CIVs to benefit from preferential treatment also will further the objectives of the Asia Region Fund Passport (ARFP).[2]

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[1] ICI Global carries out the international work of the Investment Company Institute, serving a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$19.8 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

[2] As explained in the 2014 APEC consultation paper on the passport arrangements, these objectives include: "providing investors with a more diverse range of investment opportunities;" "strengthening the capacity, expertise and international competitiveness of financial markets in the region and the fund management industry;" "growing the pool of funds available for investment in the region;" and "deepening the region's capital markets to attract finance for growth in the region." http://fundspassport.apec.org/files/2014/04/20140411-Consultation-Paper-on-the-Passport-Arrangements-FINAL.pdf.

Introduction

These comments respond to the CIV non-resident withholding taxes consultation paper issued by the Australian Treasury on 3 November 2016.[3] Our views on policy proposals in relation to CIV withholding taxes reflect the global perspective of our geographically-diverse membership. Because only some of the CIVs we represent are members of the Australian funds management sector, we are responding to only a few questions.[4] Rather than support any of the three proposals included in the consultation paper, we urge that withholding tax simplifications and concessions be available equally to all CIVs. This uniform treatment will maximize inbound investment and conform to the ARFP's objective of developing a more unified investment market within the Asia-Pacific region.

We support the consultation paper's focus on tax incentives to enhance the effectiveness and competitiveness of CIVs. Not only do CIVs provide many important benefits to investors, as described below, but they also are a very attractive source of "non-controlling" capital. Because CIVs typically make only portfolio investments, the management of Australian companies typically will remain with the companies rather than with an outsider.

Background

CIVs provide investors, particularly those of relatively modest means, with a diversified and professionally-managed vehicle for reaching their most important savings goals (including adequate retirement savings). The substantial advantages that CIVs provide to investors are consistent across international borders. Specifically, they include professional management, diversification, and reasonable cost, as well as the benefit of substantive government regulation and oversight.

The ARFP is designed to provide investors with a more competitive, more efficient, and therefore more beneficial range of CIV investment options. We strongly support the ARFP.

For many CIV investors in today's "pre-ARFP" world, factors such as residence-country marketing requirements and/or tax regimes provide a strong incentive to purchase "home-country" funds. Other factors – including the investment expertise of a "foreign" fund manager (such as when investing in its "own" country) – might lead an investor, on the other hand, to prefer "foreign" funds. To the extent that the ARFP eliminates "artificial" regulatory and/or tax incentives to prefer "home-country" or "foreign" CIVs, investors will benefit.

Tax can be a significant cost on CIV investors – particularly when their CIVs invest cross-border. By simplifying and reducing withholding taxes on non-resident investors, countries can expand sources of capital for their local companies.

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[3] http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/CIV-non-resident-withholding-taxes.

[4] We are not responding, for example, to the "simplicity" questions. We understand from the Financial Services Council (FSC) that the different rates applied to different types of dividends (*e.g.,* franked or unfranked), interest (*e.g.,* the 128F exemption), and/or other income create investor confusion. This confusion, we further understand from our discussions with the FSC, led directly to Proposal B.

ICI Global has actively supported the ARFP. Our July 2014 submission[5] was particularly supportive of tax regimes in ARFP participating jurisdictions that provided investors with the same withholding tax treatment regardless of where the CIV was organized. All investors and all source countries (*i.e.,* the countries in which the CIVs invest) benefit when investment decisions are based upon relative performance rather than tax incentives that favour one country's CIVs over others.

Response to Consultation Questions

Question 1: To what extent do you expect growth in funds and the funds management sector to come from, increased investments by non-residents in (1) foreign assets (conduit investments) and (2) Australian assets?

Whether growth in CIVs will be attributable to increased investments by non-residents in foreign or Australian assets will depend, in large part, on the relative after-tax returns arising from such assets. Tax incentives, such as simplified and lower Australian withholding taxes on non-resident investors, will enhance growth in CIVs investing in Australian assets.

Investors seeking cross-border diversification will consider factors such as investment complexity, the expected investment return in different markets, and the degree to which those returns are reduced by withholding taxes. Relative performance should be measured based upon after-tax, rather than pre-tax, returns. Whether non-residents will prefer to invest in Australia relative to other countries will depend largely on expected investment returns and all expenses (including tax). Any withholding tax simplification and reduction implemented by Australia obviously will make Australia a more attractive investment destination.

Additionally, it is important to emphasize that CIV growth can be expected to continue, and at an accelerating rate, as more individuals become familiar with the many benefits provided by these regulated investment vehicles. Asset diversification, both between individual companies and across national borders, is key to any coherent investment strategy. CIVs are uniquely positioned to help investors meet their diversification needs.

Question 4: To what extent would any reduction in Australian withholding tax rates be clawed back by higher foreign taxes (through reduced foreign tax credits)? Please provide examples in other jurisdictions.

Although the impact of withholding taxes on non-resident CIVs and their investors varies by jurisdiction and/or the nature of the CIV investor, reductions in Australian withholding tax rates typically would *not* be clawed back by higher foreign taxes (through lower foreign tax credits). This is particularly the case when CIV investments are compared with those made by direct investors in the same securities. In the "direct investor" situation, foreign tax credits typically are available to reduce tax otherwise due in the investor's residence country. In the CIV investor context, as explained below, foreign tax credits are available much less frequently.

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[5] This submission – hereinafter referred to as the "July 2014 ICI Global Submission" – is attached. The Appendix' tax discussion describes our views in detail.

So, reducing Australian withholding taxes will not necessarily lead to a shift of tax revenues from Australia to an investor's home government (through lower foreign tax credits). Instead, as explained below, reducing Australia's withholding taxes will lead to higher returns for investors – and greater interest in investing in Australia.

Importantly, withholding tax imposed on non-residents (such as retirement accounts) that do not incur any current tax in their residence countries never are clawed back by higher residence-country taxes – because there is no residence-country tax to be offset by a foreign tax credit; instead, withholding taxes result in a dollar-for-dollar reduction in investment return. Because retirement accounts can hold a substantial portion of a CIV's shares (*e.g.,* over 50%, on average, in US equity funds),[6] withholding taxes on non-residents can have a significant impact on investment decisions made by a CIV's manager. While the treatment of retirement accounts investing through a CIV is no less favourable than that of a pension fund investing directly, retirement accounts investing through a CIV do not make portfolio management decisions and, therefore, cannot manage the tax effects of their investments.

Withholding taxes on non-resident CIVs also can be a significant impediment to cross-border investing if a CIV incurs little (or no) tax on a current basis and retains, rather than distributes to investors, its net return. In this factual situation, there is little (or no) current tax at either the CIV or the CIV investor level that may be reduced by a foreign tax credit. Because many globally-distributed funds fall into this "little/no tax" and "no distribution" category, withholding taxes imposed on non-resident CIVs typically are a non-recoverable cost. Even if an investor's residence country deemed the investor to receive currently his/her allocable share of the CIV's income, we are not aware of any anti-deferral rule that also would provide a foreign tax credit.

Finally, in countries such as the United States that require annual distributions of a CIV's income and provide a mechanism by which foreign tax credits may be provided to CIV investors, the investors' ability to claim such credits can be limited in several ways. First, the CIV's country of residence may impose restrictions on a CIV's ability to "flow through" to its shareholders the foreign tax credit (and the taxable income on which the tax was withheld). In the US, for example, the election to flow through foreign tax credits to shareholders can be made only if more than 50% of the CIV's total assets at the close of its taxable year consist of stock or securities of foreign corporations.[7] This credit, however, is not available (as noted above) for the US CIV's retirement account investors. Likewise, the credit cannot be used to reduce withholding tax imposed by the US on distributions to non-resident investors. Finally, to our knowledge, no foreign government provides a credit against its home-country tax for withholding tax imposed on the US CIV by a third country.

Consequently, withholding taxes imposed on non-resident CIVs – were one to generalize – are a "sunk" cost that cannot be recovered through foreign tax credits. Thus, any reduction in Australia's withholding tax on non-residents will have a positive impact on investments by non-resident CIVs.

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[6] The net assets of US mutual funds with an equity investment objective, at 31 December 2015, totaled USD 8,148.75 billion. The total net assets of defined contribution (DC) plans and individual retirement accounts (IRAs) in these funds, at 31 December 2015, totaled USD 4,116 billion. http://www.icifactbook.org/data/16_fb_data, tables 4, 63, and 64.

[7] 26 USC §853(a)(1).

Specific Recommendation Regarding Australia's Withholding Tax on Non-Resident Investors

ICI Global's comments on the ARFP consistently have called for "tax neutrality, tax certainty, and tax administration harmonization."[8] More directly, in this context, we stated that:

> Tax neutrality should be an important priority. Specifically, the tax laws of neither the home nor the host country should provide investors with a tax incentive to favour one country's funds over another country's funds. Tax neutrality will prevent some markets from effectively being "off limits" to fund managers because their funds cannot compete from a tax perspective.[9]

Of the three proposals advanced in the consultation paper, only Proposal A (the "no change" proposal) would not raise any new tax neutrality consideration. As we understand Proposals B and C, they may provide a competitive advantage to Australian CIVs vis-à-vis CIVs organized in other jurisdictions (whether or not a jurisdiction participates in the ARFP).

Because simplified and reduced withholding tax rates will benefit CIV investors, increase inbound investment, and thereby enhance the Australian economy, we suggest an alternative proposal. Specifically, we recommend that any simplified withholding tax rules and potential rate reductions be broadly available to all CIVs.

For the ARFP to achieve its objectives, no tax benefit should be provided to any ARFP-participating country's CIVs over those of any other ARFP-participating country.[10] Were favourable treatment provided only for Australian CIVs, other countries might be encouraged to erect similar tax-relief barriers that would harm non-resident CIVs. Such barriers, for example, would make Australian CIVs less attractive than "home country" CIVs for making "home country" investments.

The benefits to the Australian economy will be even greater if withholding tax simplification and rate relief is equally available to all CIVs – irrespective of whether or not they are organized in an ARFP-participating jurisdiction. We propose that the term CIV be defined as it was in the OECD's 2010 CIV Report[11] that was prepared with the support of all OECD members – including Australia. Specifically, the term CIV would be "limited to funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established."[12]

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[8] July 2014 ICI Global Submission, page 4.

[9] July 2014 ICI Global Submission, page 19.

[10] As stated by Minister Cormann on 11 September 2015, upon the signing of the Passport Statement of Understanding, "Members of the Asia Region Funds Passport Working Group . . . and the funds management industry are now working on aspects of the region's tax regimes to ensure the international competitiveness of the Passport."

[11] The 2010 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.

[12] 2010 CIV Report, page 3.

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We appreciate this opportunity to comment on the November 2016 CIV non-resident withholding taxes consultation paper. Please feel free to contact the undersigned at your convenience if ICI Global can provide you with any additional information.

With kind regards,

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Submitted via Email

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Re: Consultation Paper: Arrangements for an Asia Region Funds Passport

Dear Ladies and Gentlemen,

ICI Global applauds the efforts of the participating Asia-Pacific Economic Cooperation (APEC) members to develop the proposed arrangements for the Asia Region Funds Passport ("the Passport" or a "Passport Fund") described in the APEC Consultation Paper: Arrangements for an Asia Region Funds Passport ("Consultation Paper").[1] Under the proposed framework, investors in the Passport Fund economies will gain the ability to invest in regulated funds that are "passported" from other member economies. ICI Global believes that the Passport should encourage competition, lower costs and spur fund managers to innovate and find ways to offer superior services and products – all to the benefit of investors.

ICI Global, the international arm of the Investment Company Institute, is a global fund trade organization with offices in Hong Kong, London and Washington, D.C. ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$18.6 trillion. We count among our membership 12 Asia headquartered fund managers and many more of our members have significant operations in Asia. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision.

[1] The Consultation Paper is available at http://fundspassport.apec.org/files/2014/04/20140411-Consultation-Paper-on-the-Passport-Arrangements-FINAL.pdf.

Regulated funds provide important advantages to investors including professional management, diversification, and reasonable cost as well as the benefit of substantive government regulation and oversight. A strong regulated funds industry can support your goal of deepening the region's financial markets. The regulated fund markets of Australia, Korea, New Zealand, Singapore, Thailand and the Philippines have experienced significant growth in total fund assets under management since 2008. We believe the Passport is both a timely and exciting initiative for the region.[2]

ICI Global members are experienced in managing and distributing regulated funds in many countries, including in the Asia region, and have a strong interest in the success of the Passport. The Consultation Paper sets forth a comprehensive Passport framework based on the rules in the domicile of the fund and the operator ("home economy"), the rules in the country where the fund is passported ("host economy") and Passport rules. ICI Global appreciates that a key objective of the Passport is to provide high standards for investor protection. We support the goal for Passport Funds to develop an early reputation for being transparent, well-regulated funds.

We understand that this cross-border fund framework was drafted to be consistent with the objective that Passport Funds be relatively non-complex investments. Consistent with that principle and in light of the goals and objectives of the Passport, we provide some recommendations that we believe will make it a more attractive and workable cross-border fund vehicle. We appreciate the opportunity to comment on the Passport.

Executive Summary of Recommendations

Summarised below are recommendations that we believe will improve the utility of the proposed framework:

- Eligibility.
    - At a minimum, the following fund structures should be permitted: corporate, contractual and trust.
    - A fund should be an eligible Passport Fund if it is eligible to be offered to the public in the home economy (*e.g.,* made available on home economy website).
    - Regulators should reconcile any incompatibilities in home and host economy rules related to money market funds.
    - We support improving disclosure to strengthen investor understanding of the purchase and sale of Exchange Traded Funds (ETFs). While we support finding ways to strengthen the ability of ETF investors to sell their shares, we do not support the proposal to ensure shares of the ETF are redeemable when trading has been suspended for more than five days. We believe such an approach presents both practical and operational problems and could potentially harm investors and exacerbate market disruptions.

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[2] Plantier, L. Christopher. 2014. 'Globalisation and the Global Growth of Long-Term Mutual Funds.' *ICI Global Research Perspective* 1, no. 1 (March), available at www.iciglobal.org/pdf/icig_per01-01.pdf. Annex A provides a more fulsome discussion of the economic objectives of the Passport and regional factors expected to be influential in the growth of regulated funds.

- Fund Operator. We recommend permitting additional ways in which the fund operator can meet the experience qualifications. We believe that, given the overall strength of the Passport framework, more flexibility in qualifications can be provided without compromising the goal of ensuring there is a responsible fund operator. The funds under management threshold also should include discretionary and separately managed accounts that are managed similarly to the funds that are eligible for the threshold. We are concerned the capital requirements may be too high when compared with member economy requirements and therefore unnecessarily restrict the number of eligible operators.

- Passport Fund.

    - Custody Arrangements. Consistent with rules in certain member economies, we recommend considering conditions under which a Passport Fund can use a custodian outside the home economy, such as limiting eligibility to certain financial institutions.

    - Independent Oversight. We support the concept of independent oversight but recommend more flexibility in its implementation to better accommodate different fund structures (*e.g.,* contractual or trust) and local rules which may impose certain oversight responsibilities on specific entities or otherwise affect how oversight is conducted.

    - Compliance Opinion. We agree that obtaining an audit opinion on compliance with certain home economy rules and the Passport rules could be difficult and expensive. The cost could be a competitive disadvantage when compared with local funds, too. We recommend examining how existing local audit requirements could be used, and adapted as needed, to meet this proposed Passport rule so only one audit is needed. We also agree that an independent oversight entity could have a role in an annual review. Passport Funds could have the option of seeking an audit opinion or could utilise an independent oversight entity (which could use internal and external auditors, compliance personnel or other experts in the performance of this review). We believe allowing either an opinion or a compliance review by an independent oversight entity equally fulfils the goal of ensuring strong compliance in Passport Funds.

    - Investment Restrictions. We recommend certain changes to the investment restriction provisions to enable more efficient portfolio management, including to better hedge risk exposures for the benefit of investors. We also recommend more consideration of how the proposed investment restrictions compare to current member economy investment restrictions (*e.g.*, group and single entity limits, investments in other CIS, derivatives and securities lending). Generally this comparison should ensure that a reasonable and comparable set of investment restrictions are applied under the Passport as compared to local funds.

    - Delegation. We recommend other approaches for ensuring operators can enter into reasonable delegation arrangements that allow them to access important expertise wherever located – in or outside a member economy. Along with notice to supervisors of a delegation, delegates could be required to be licensed for asset management in their local jurisdiction. Operators also could be required to have written agreements with delegates and engage in specified due diligence.

  - Other Issues - Share Classes. To facilitate distribution, particularly to accommodate the existence of different currencies in the region, the Passport rules should permit multi-class fund structures.

- Dealing with Investors – Marketing and Disclosure. We recommend considering how arrangements for marketing in host economies can be improved to facilitate more efficient distribution of Passport Funds. Consideration must be given to the substantial burdens and costs that licensing in multiple host economies would entail (*e.g.*, "simplified" licensing for entities marketing Passport Funds). In the future, we recommend that Passport members work together on a common disclosure document to avoid the problems posed when the same fund must use different documents in each host economy to comply with local laws. Such a disclosure document also would have to be comparable to host economy disclosure documents so investors receive the "same level" of disclosure.

- Implementation. We recommend the formation of a college or group of representatives from member economies to monitor Passport developments and to help develop solutions when areas of divergence in the implementation of the Passport arise among member economies.

- Tax. Tax issues present crucial challenges for funds distributed cross-border. Three or more jurisdictions – the fund's domicile, the investors' tax residencies and the countries in which the fund invests – must be examined. The tax issues that must be addressed for a Passport Fund to be competitively viable across all Passport economies involve tax neutrality, tax certainty and tax administration harmonization. To ensure that tax issues do not erode the benefits of investing in a Passport Fund, we recommend that the Passport member economies work together to identify and address tax issues.

  - We have identified some specific issues, discussed below, involving tax rules of certain APEC member jurisdictions that are not tax neutral; these laws must be modified for the Passport to be successful.

  - For other issues, administrative guidance – to eliminate tax uncertainty and overly-burdensome or inconsistent procedures that can prevent or diminish cross-border investments – will be necessary.

Comments on Substantive Requirements

The Consultation Paper envisages that a combination of home, host and Passport rules will apply to various aspects of the operation, management and investment activities of Passport Funds.

Basic Eligibility (Questions 3.1-3.6)

Types of Collective Investment Scheme (Question 3.1): The permitted organisational structures should include at a minimum the following: corporate, contractual and trust structures. These are common forms of organisation in the region and therefore regulators, investors and fund managers are familiar with them. Local laws also are well developed to support these forms of organisation.

Money Market Funds (Question 3.2): We are concerned that there could be incompatible requirements between home and host countries, *e.g.*, different substantive rules on what investments a fund labelled as a "money market fund" may make. For example, a home economy rule may not permit a fund to label itself a money market fund unless it complies with home economy rules. If the host economy rules are different, such as regarding eligible assets,

daily or weekly liquid assets, or limits on weighted average life or maturity, this would present challenges for the operator. It may mean that the home economy rule could be violated. Alternatively if the home economy rule is more detailed or "stricter" such that compliance with that rule is compliance with the host economy rule, it may mean the Passport Fund cannot be competitive with host economy money market funds. We do understand that the details of money market fund rules may differ between jurisdictions, *e.g.*, different currencies and markets.[3] We recommend the region evaluate the local rules and work out differences where necessary.

ETFs (Questions 3.3-3.4 and Discussion, page 38): Question 3.3 asks for insight into the possibility of Passport ETFs being offered but not traded on a market in a host economy. Our members believe such a possibility to be remote. Question 3.4 raises concerns about investors not fully understanding how they can "realise their investment" in a Passport ETF not traded in the host economy. We agree disclosure should be clear that an ETF is a Passport ETF but do not believe additional disclosure is needed. We believe investors should understand this point because if the Passport ETF is only traded on an ETF's home exchange then the investor would need a broker who can trade on that exchange in order to purchase or sell shares of the Passport ETF.

The Passport rules require an ETF to comply with host economy rules and take reasonable steps to ensure shares can be sold at a price not materially different from the Passport ETF's NAV. These steps include special arrangements for issuance and redemption at NAV to enable arbitrage and engaging a market maker. In addition, if shares are suspended from trading for more than five consecutive days, the fund must take steps to allow shareholders to redeem.

ETFs should not be required to take redemptions from secondary market investors. An ETF that must be ready to redeem its own shares from secondary market investors would face significant management and operational issues.[4] In fact, a requirement that ETFs accept redemptions directly from shareholders when trading is suspended also could harm investors, and potentially exacerbate market conditions. Rather than requiring ETFs to accept redemptions directly, we believe efforts should be made to ensure secondary market investors have a clear understanding of their status and rights with respect to purchasing and selling shares of ETFs. For example, in some countries ETFs provide additional disclosure in offering documents and marketing communications, *e.g.,* UCITS ETFs and ETFs registered under the Investment Company Act of 1940 ("1940 Act").[5] These efforts are important to enhancing investors' understanding of ETFs.

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[3] *See* IOSCO, Final Report, Policy Recommendations for Money Market Funds (October 2012) available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD392.pdf. (each jurisdiction should define liquidity thresholds depending on the specificities of their market).

[4] Redemptions to secondary market investors in cash or in specie are both problematic. Physical ETFs typically create and redeem large blocks of shares in specie. This process allows the ETF to be fully invested, *i.e.*, not need to maintain cash on hand to meet daily redemptions, which is one key benefit of the ETF structure. To be prepared for the possibility that individual investors may be able to redeem small share amounts in cash, the ETF would likely need to maintain more cash in its portfolio, which would impact the ETF's portfolio management, expenses and returns, and would diminish this benefit of the ETF structure. Providing redemptions to individual investors in specie, however, would likely be unfeasible, in large part because frequently an investor's ETF shares would translate into fractional shares of the underlying securities, which may not be transferred.

[5] *See* Guidelines on ETFs and other UCITS issues, ESMA, 18 December 2012, available from http://www.esma.europa.eu/system/files/2012-832en_guidelines_on_etfs_and_other_ucits_issues.pdf. In the United States, the disclosure form requires ETFs to state, among other things, that individual shares may only be purchased and sold on a national securities exchange through a broker dealer, that investors may pay brokerage commissions on their purchases and sales, that the price of shares is based on market price, and that shares may trade at a price greater than or less than NAV. ETFs are also required to describe the principal risks of investing in the fund; these disclosures typically include additional information about the nature and potential risks of secondary market trading. For example, ETFs typically explain that it is possible that an active trading market in the ETF shares may not be maintained, and that trading may be halted due to market conditions.

Home Economy Public Offer (Question 3.5-3.6): It is proposed that a Passport Fund must be subject to an "ongoing offer of the interests in its home economy." Whether a fund is actively promoted in the home economy should not limit its eligibility as a Passport Fund because, regardless of its offering activity, such a fund has been authorised and is fully subject to all applicable requirements and supervisory oversight. A fund should be eligible if it is authorised by its home economy supervisor and is eligible to be offered to the public in its own economy (*e.g.,* made available on the home economy website).

Licensing of Passport Fund Operators (Questions 3.7-3.16)

Generally, home economy rules apply to licensing of the Passport Fund operator but there are additional Passport rules to ensure adequate capital and competence. The operator must be in the Passport Fund's domicile.[6] We are concerned some requirements may be unnecessarily restrictive when considered along with the comprehensive fund requirements and supervisory oversight that also ensure a strong, responsible fund operator. For Questions 3.7-3.9, regarding the compliance audit, see our discussion below in the section entitled "Operation of the Passport Fund." We have the following recommendations:

Track Record of Operator (Discussion, page 15). Eligible experience includes experience operating CIS offered to retail investors in jurisdictions with regulation that is comparable to that of the home economy (in the opinion of the home economy supervisor). We encourage member economies to take strong and early steps towards recognizing the comparable non-member economies so operators understand what experience can be counted for the track record requirement. The member economies also may want to publish a list together.

Qualifications of the Officers of the Fund Operator (Questions 3.12-3.14): We are concerned that the proposed requirements may unnecessarily limit entrants. For example, requirements focused on a "minimum number of years" can operate too rigidly. We recommend including other ways that officers can satisfy the minimum qualification such as through specified education levels, other relevant qualifications (e.g., certified financial planner or analyst) and types and ranges of experience (not just length in specific positions).[7] We note that in considering the track record of the operator for purposes of assessing its experience, the proposed requirements permit, under certain conditions, the experience of a related party to be considered. A similar approach also could be used to assess the experience of the officers. For example, the role and experience of an affiliate's or parent's officers could be relevant.

An additional operator qualification is that at least one person responsible for making discretionary investment decisions be an officer or employee of the operator. It is important

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[6] The approach to the location of the fund operator has recently evolved in the European Union (EU) to permit a "management company passport" for UCITS and for EU alternative investment funds under the Alternative Investment Fund Managers Directive (AIFMD). *See* Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast), (referred to in this letter as "the UCITS Directive"), available from http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0032:0096:en:PDF; and Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, available from http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF (referred to as the AIFMD, or a manager as an AIFM). In the United States, no geographic presence is required for investment advisers registered with the Securities and Exchange Commission.

[7] The AIFMD requires that operators "employ sufficient personnel with the skills, knowledge and expertise necessary for discharging the responsibilities allocated to them" and takes account of "the nature, scale and complexity" of the operator's business and "the nature and range of services and activities undertaken in the course of that business." AIFMD, Article 22, *supra* note 6. *See also* UCITS Directive, Article 7, *supra* note 6 (authorization of UCITS management companies).

that this provision not require that this officer be physically located in the home economy. For example, a fund and fund operator located in a home economy may be offering a fund with an investment strategy focused on the host economy that utilises expertise in the host economy, *e.g.*, a Singapore operator and domiciled fund offered in Australia focused on Australian equities. Given the comprehensive nature of the Passport framework, a physical presence for this purpose is not needed to ensure there is appropriate investor protection and supervisory oversight. The operator will be licensed and supervised by its home economy regulator and will have responsibility over its employees wherever located.

Capital (Questions 3.15 and 3.16): The proposed capital amounts (and how calculated) are in some cases much higher than the capital requirements of member economies. This is likely to limit the number and type of operators. We do support allowing professional indemnity insurance as a substitute for some capital, an approach used in Singapore and in the European Union.

Funds Under Management Threshold (Discussion, page 18): The framework requires the operator to have at least US$500mn in assets under management in investment schemes that in turn invest at least 50% of their assets in assets that would be eligible for Passport Funds. We believe assets managed through discretionary or managed accounts also should be relevant under the same conditions. It would not be uncommon for operators to manage assets through separate accounts with investment strategies and objectives that are substantially similar or identical to those the operator intends to offer through a Passport Fund and therefore such account should be eligible to be included.

Operation of the Passport Fund (Questions 3.17-3.28)

The home economy rules are proposed as the baseline for operation of a Passport Fund with Passport rules supplementing those requirements. Host economy rules will not apply.

Custody (Discussion, pages 19-20): The framework requires that the custodian be appropriately authorised by the home regulator and permits delegation to a subcustodian so long as the operator or custodian retains responsibility. We are aware that some Passport member economies would permit their local funds to use a non-resident custodian under certain conditions. For cross-border funds, it may be more efficient to utilise a non-resident custodian. We recommend considering additional conditions that could apply to custodial arrangements that would permit a fund to use custodians outside the home economy. For example, the rules could limit eligible custodians to only certain types of authorised financial institutions.

Independent Oversight (Question 3.17): We support the concept of independent oversight but the approach must accommodate different fund structures and existing member economy rules to be workable and successful. When IOSCO examined fund governance and its "one primary general principle" - independent review and oversight - it identified five fund structures, based on variations of the corporate or contractual form, which impacted independent oversight. IOSCO observed that within each fund model there were different review and oversight structures. There were differences in approach between corporate and contractual and jurisdictions effectuated the principles for independent oversight differently, too. IOSCO also recognized that some jurisdictions mandated that specific entities take on certain functions, *e.g.*, an auditor, a depositary, a board, a committee.[8] The role of the regulator also was highlighted.

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[8] IOSCO, Final Report: Examination of Governance for CIS, Part I (June 2006) available at http://www.iosco.org/library/pubdocs/pdf/IOSCO PD219.pdf ("IOSCO Part I"). Part I describes various governance models around the world and the duties of independent oversight entities.

In its conclusions on this work, IOSCO found there was no one unique solution. In some cases, IOSCO stated one single entity was simply unrealistic, for example in a contractual structure. In those circumstances, IOSCO recommended alternatives such as a "setup of different entities" to accomplish the governance function, including independent oversight[9]. IOSCO stated that a mix of solutions was available so that various roles can be allocated to the most relevant entities. Several approaches for contractual and other fund organisational structures are described in the two IOSCO papers.

We recommend that the Passport framework follow a similar approach that is more flexible and accommodates the different organisational forms and also the ways in which supervisors in member economies have defined the duties and the entities that provide the oversight. Such an approach will ensure that there is independent oversight but will be less likely to be incompatible with certain fund structures or in conflict with existing local requirements.

Compliance Audit (Questions 3.7-3.9 and 3.18-3.21): As raised in Question 3.20, we agree that obtaining an annual compliance audit opinion relating to the compliance of the Passport Fund with the Passport rules and certain home economy rules could be challenging. There will be complexity due to the interaction between the home and Passport rules. In addition, this requirement could in effect require a second audit when there is a local requirement for an audit too. We support the goals of the compliance audit and think, as suggested in the consultation, that there are other ways the purposes of the audit can be achieved. We also are concerned that the expense of obtaining this annual opinion would raise genuine competitive issues for Passport Funds and their operators.

We recommend examining how existing local audit requirements could be adapted to meet this proposed Passport rule so only one audit is needed for such funds, *i.e.,* the audit meets a Passport requirement and a home country requirement. It will be too costly and inefficient for funds already subject to a local audit requirement to seek another audit if required under the Passport. We also recommend considering a role for the independent oversight entity (or entities) consistent with our recommendation above for independent oversight to be structured more flexibly.

As suggested by Question 3.18, we agree that a compliance review would be an appropriate function for independent oversight entities. This also is consistent with the IOSCO work on independent oversight. Passport Funds could have the option of seeking an audit opinion or utilizing the independent oversight entity (or entities) (which could use internal or external auditors, compliance personnel or other experts in the performance of the review). We believe this approach, allowing an opinion or a compliance review, equally fulfils the goal of ensuring strong compliance in Passport Funds.

As discussed above, IOSCO has analysed and promoted the oversight role carried out by an independent entity to ensure a fund is operated efficiently and in the interests of fund investors.[10] IOSCO recognized the need for sufficient powers to perform oversight

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[9] IOSCO, Examination of Governance for CIS, Part II Independence Criteria, Empowerment Conditions and Functions to be performed by "Independent Oversight Entities" (June 2006) available at http://www.cmvm.pt/CMVM/Cooperacao%20Internacional/Docs%20Iosco/Documents/IOSCOUCITS2.pdf ("IOSCO Part II").

[10] *See* IOSCO Part I, *supra* note *8*, and IOSCO Part II, *supra* note 9.

responsibilities, including reviewing legal and operational conditions. Several approaches across many jurisdictions were described in IOSCO's work.[11]

Investment Restrictions (Questions 3.22-3.25): The Consultation Paper states that the types of assets allowed to be held by a Passport Fund are intended to support the reputation of the Passport Fund as a vehicle with liquid investments that are readily able to be priced. Additionally, an objective of the Passport is to increase the diversity of regulated funds available to investors. This diversity includes not only the location of funds but their geographic investment focus and their investment type and approach. We note that some of the proposed investment restrictions reflect those already in place for regulated funds in certain Passport member economies or in other parts of the world. We recommend the following:

Coordination with Existing Member Economy Regulatory Restrictions: We believe it is very important to evaluate how the proposed investment restrictions compare with current investment restrictions for similar regulated funds in the member economies (*e.g.*, group and single entity limits, investments in other CIS, derivatives and securities lending). To ensure operators take advantage of the Passport, the investment parameters for Passport Funds must be reasonably attractive (and similar) when compared with existing fund requirements in member economies. We are concerned that if the Passport's investment restrictions are too dissimilar from current regimes, operators may have less interest in running Passport Funds because it would be both costly and operationally complex to run a Passport Fund and a non-Passport Fund that have the "same investment objectives and strategies" under rules that impose different investment restrictions. For example, managers frequently seek to offer "mirror" funds, funds with the same investment objectives and strategies, in different markets. This can be seen in UCITS and 1940 Act funds. Managers of US mutual funds can carry out similar strategies in a UCITS or in funds in other jurisdictions such as Singapore. Member economy operators also will seek the most operationally workable and efficient fund vehicle to "passport" their local funds. This means how member economy fund requirements compare with the Passport will be important.[12]

Investments in Regulated CIS (Discussion, page 29): The framework permits Passport Funds to hold, subject to conditions, interests in certain Passport economy CIS. We believe this is too narrow and recommend expanding the categories of CIS into which Passport Funds can invest to include other regulated funds that are sold to the public, including those established outside member economies. Investment into such funds, even at a limited level, would support

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[11] *Id.* In the United States, boards of directors of funds registered under the 1940 Act, which must have independent directors, are specifically involved in overseeing fund compliance. In 2003, a specific rule was adopted that gave US fund boards new tools for overseeing compliance and assigned them responsibilities, including approving compliance policies and approving the designation, compensation and removal of the chief compliance officer (CCO). There also is an annual written report to the board that at a minimum addresses certain areas, including material compliance matters that have occurred over the period. In addition, the CCO must meet separately with independent directors. *See* Board Oversight of Fund Compliance, Independent Directors Council Task Force Report (September 2009), available at http://www.idc.org/pdf/idc_09_compliance.pdf. The paper provides a description of the role of the board as well as descriptions of features that evidence a strong compliance regime.

[12] Existing arrangements between member economies that permit the sale of member economy funds in other member economies also will inform the decision on what fund vehicle to use. *See* ASIC, Regulatory Guide 178, Foreign Collective Investment Schemes, June 2012 (Singaporean CIS have been assessed as meeting certain Australian regulatory criteria).

portfolio diversification for Passport Funds, an objective of the Passport.[13] We believe a limit on investment in CIS adequately serves the purpose of ensuring that such investments are not a way to circumvent the Passport rules.

Derivatives (Question 3.2 and Discussion, page 30): Derivatives are an important investment tool for regulated investment funds, including for efficient portfolio management. We acknowledge that the use of such techniques has been considered under the Passport and that explicit allowance has been permitted for the consideration of hedging arrangements and netting arrangements to calculate the global exposure of a Passport Fund.

The framework requires that the global exposure of a Passport Fund does not exceed its gross asset value (GAV) by more than 20% (except for index funds meeting certain criteria). Imposing this limit may constrain the ability of some Passport Funds to most efficiently offset or to hedge certain risk exposures. To ensure that Passport Funds can utilise well-recognized and widely-used investment techniques for the benefit of investors, we recommend reconsidering the proposed global exposure limit. The limit of 20% is lower than that permitted in other fund regulations.[14] We note that when weight is given to all the other provisions included in this framework - the operator qualifications, the independent oversight, the other investment restrictions, supervisory oversight – it would be appropriate to re-consider the proposed limit.

Delegation (Questions 3.26-3.27): The ability to take advantage of efficiencies and expertise on a cross-border basis is part of what a Passport Fund is intended to provide for investors and the region. The Passport also is expected to facilitate the goal of offering funds that have a wider geographic focus.

For portfolio management, it is proposed that a Passport Fund ensure that a delegate is subject to regulation which, to the satisfaction of the home regulator in consultation with other Passport regulators, provides "substantially equivalent regulatory outcomes" to that applying in Passport economies. Cooperation agreements between the home regulator and the delegate's regulator also are necessary and must be as effective as those between Passport economy regulators. Delegates also must meet certain Passport operator requirements, *e.g.,* capital, experience.

We are concerned that these requirements, in their effect, are likely to unnecessarily limit the delegation of portfolio management to other entities. In some cases, it is simply not feasible for a firm to replicate operations in different locations so delegation may be the only way to access the investment expertise. Also, if member economy rules better facilitate delegation, especially on a cross-border basis, then that will impact an operator's decision on the feasibility and advantages of using a Passport Fund (versus using a local fund).

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[13] Investment could be limited to regulated funds in jurisdictions which have regulatory regimes that are consistent with IOSCO standards. *See* IOSCO, Objectives and Principles of Securities Regulation (May 2003), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf (includes principles for CIS). *See also,* 1940 Act, Section 12(d)(1) (generally provides that a 1940 Act fund may not acquire any security of another fund if, after the purchase, the 1940 Act fund would own (a) more than 3% of the acquired fund's voting stock; (b) securities of the acquired fund with a value in excess of 5% of the 1940 Act fund's total assets; or (c) securities of the acquired fund and all other funds having a value in excess of 10% of the 1940 Act fund).

[14] UCITS Directive Article 51(3) enables UCITS to use derivative instruments to gain exposure to eligible assets as long as the global exposure relating to financial derivative instruments does not exceed 100 percent of the total net value of the UCITS portfolio. Generally, the 1940 Act prohibits an open-end fund from issuing or selling any senior security other than a bank borrowing unless it maintains 300% asset coverage. *See* Securities and Exchange Commission, Use of Derivatives by Investment Companies under the Investment Company Act of 1940, Release IC-29776 (August 31, 2011), available at http://www.sec.gov/rules/concept/2011/ic-29776.pdf (generally describes restrictions on the use of derivatives in regulated funds under the 1940 Act in the United States and other regulatory approaches in the European Union, Singapore and Hong Kong).

On the equivalence evaluation, we are very concerned that seeking to find equivalent regulatory outcomes in regimes of other countries will be very difficult and time-consuming. Such a process will be complex and also presents issues when laws change – either in the Passport economies or elsewhere. The process and mechanisms for making this finding among the group of regulators are unclear, too.

Nevertheless we appreciate concerns that functions conducted outside a country may compromise the ability of regulators to supervise and adequately protect investors. We also are sensitive to the concern that delegation not be a means to circumvent the Passport's regulatory requirements. To achieve an appropriate balance, we believe that there are a number of ways proper supervision can be achieved while allowing appropriate delegation and ensuring adequate investor protection.

For example, as proposed under the Passport framework, the operator has supervisory and monitoring responsibilities over the delegate and remains responsible for the delegated function. It therefore is unnecessary to duplicate the operator qualifications in a delegate as it is not the operator. Instead, one approach could be that delegates who are not resident but performing services could consent to supervision for purposes of cross-border activities with respect to the Passport Fund. This means supervisors would be in a position, alongside the operator, to monitor delegates and enforce the Passport rules. In addition, it is important to remember that the independent oversight entity or entities also have a role in the oversight of service providers.[15]

Another approach for delegation is to require notification of any delegations to supervisors and a requirement that a portfolio management delegate be authorised for asset management, including investment and portfolio management, and supervised for that purpose. We agree, as proposed in the framework, that a cooperation agreement with the delegate's regulator is another useful approach. A requirement that a delegation arrangement be in writing is also an approach used in other jurisdictions. The written agreement should clearly and fully set forth the obligations and responsibilities of the parties as well as the mechanisms by which the operator is able to effectively supervise the delegate. A written agreement is important for the parties as well as supervisory authorities. Requirements for due diligence of delegates prior to engagement also could foster more confidence in these arrangements. These approaches, or a combination, are all approaches used successfully in other jurisdictions to effectively manage delegation.

Share Classes

There is no proposal related to Passport Funds and the possibility to have multi-class structures. We are aware that some Passport economies may not authorise such a structure for funds. Share classes are particularly important for a cross-border fund, particularly given the different currencies in the region. We recommend a Passport rule that allows multi-class fund structures.

Dealing with Investors – Marketing and Disclosure

In general, host economy rules apply to a Passport Fund's dealings with investors, including marketing and Passport Fund disclosure.

For marketing, host economy rules may present challenges for the Passport as current licensing frameworks in certain member economies do not extend to foreign domiciled entities thereby restricting marketing activities by Passport operators. Rules also may be unclear which inhibit

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[15] *See e.g.,* IOSCO Part II, *supra.* note 9; Independent Directors Council, Board Oversight of Certain Service Providers, June 2007, available at http://www.ici.org/pdf/21229.pdf.

marketing by foreign operators. Local licensing requirements often entail physical presence. Managing the costs along with the compliance infrastructure for differing and multiple regulatory regimes is daunting. While the Passport enables operators to access investors in host economies, the framework also must support efficient distribution and marketing of a Passport Fund to ensure success of the framework. We recommend considering how arrangements for marketing in host economies can be improved to facilitate efficient distribution (*e.g.,* "simplified" licensing for entities marketing Passport Funds).

On investor disclosure, we understand that this concept allows Passport Fund documents to "look like" host economy fund documents. For a cross-border fund, the production of different fund documents for the same fund is complex, expensive and potentially creates regulatory risk. In addition, investors in different host economies should receive similar information about a fund. To this end, we believe it will be important that the Passport economies work together to harmonise Passport Fund disclosure rules with the goal that cross-border funds could deal with investors with a single document for all Passport economies.[16] It would be important that such a disclosure document also be comparable to host economy disclosure documents so investors receive the "same level" of disclosure whether investing in a host economy fund or a Passport Fund.

Implementation of the Passport Framework

The regulatory framework envisaged for Passport Funds is akin to that applicable to funds being distributed under the UCITS rules. Such a cross-border framework has to accommodate the laws of the fund's domicile, the local laws that implement the UCITS Directive and the laws of those countries where the fund is distributed to investors. This has led to challenges concerning the interpretation and enforcement of rules by different authorities. These differences result in uncertainty, which can undermine confidence.

Serious consideration should be given to the creation of a mechanism through which differences in the approaches adopted by member economy supervisors to the cumulative rules imposed on Passport Funds can be identified and managed. One such mechanism could be the creation of a college of supervisors comprised of representatives from regulators in the Passport member economies.[17] The college could have a mandate to monitor Passport developments and help resolve differences in implementation while promoting coordination, harmonisation and convergence of the Passport rules and their implementation.

Tax Issues and Impacts for Passport Funds

Although tax issues generally are beyond the scope of this consultation, our members consistently have identified tax as a key issue that must be addressed, comprehensively and quickly, by any country adopting the Passport. These issues are discussed in detail in Annex B.

Many of these issues involve "tax neutrality." By tax neutrality, we mean eliminating tax incentives that effectively encourage either home or host economy investors to prefer home or

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[16] We note that the Consultation Paper does not address the various anti-money laundering (AML) requirements that are in place across Passport economies. Differences in AML requirements may present barriers or challenges for efficiently distributing into certain Passport economies. We encourage the consideration of the work of the Financial Action Task Force (FATF), an inter-governmental body that sets standards and promotes effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.

[17] *See* "Good Practice Principles on Supervisory Colleges" Financial Stability Board (2010), available at http://www.financialstabilityboard.org/cos/cos_101012.htm.

host economy funds. The Passport will not be successful if tax considerations act as a barrier to cross-border fund sales.

A home economy's rules, for example, can either harm or help home economy ("local") funds in a Passport economy. Local funds are harmed, for example, when a home economy imposes withholding tax on amounts, distributed by these funds to non-resident ("foreign") investors, which are exempt from such tax when received by foreign funds.[18] Local funds also are harmed when local laws require local funds to distribute taxable income annually but allow local investors to invest in foreign funds that retain income (and thereby defer tax).[19] Foreign funds are harmed, in contrast, when host-economy laws provide more favourable tax treatment for distributions by their local funds to local investors than they provide for distributions by foreign funds to these local investors.[20]

Other issues involve ensuring that the activities of fund managers are taxed appropriately in each country in which their fund shares are sold. An excessive tax burden, such as one arising from an expansive view of what activities constitute a taxable presence, can restrict a fund manager's activities in a host economy; in the extreme case, a fund manager would avoid a host economy entirely and investing opportunities for individuals will be limited.[21]

An overriding tax consideration – applicable both to fund investors and fund managers – is the need for tax certainty; one aspect of this certainty involves clear and administrable rules of tax administration. Without certainty regarding the tax consequences of a fund's portfolio investment, and any procedural requirements for claiming treaty benefits, the price at which a fund's shares are purchased and sold (the net asset value or NAV) cannot be determined accurately.[22]

We recognize that tax issues are complex and based predominantly on sovereign legislation. To the extent that tax considerations are not within the nexus of the ministries that have published the consultation, we recommend that relevant officials in the member economies identify and address, where possible, tax issues that would negatively impact the Passport.

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[18] This tax-neutrality issue, a version of which arises in Australia, is discussed in Part 1.A of Annex B and illustrated by Examples Tax-1 and Tax-2.

[19] This tax-neutrality issue, a version of which arises in both Australia and Korea, is discussed in Part 1.B of Annex B and illustrated by Examples Tax-3, Tax-4 and Tax-5.

[20] This tax-neutrality issue, a version of which arises in Korea, is discussed in Part 1.C of Annex B and illustrated by Examples Tax-6 and Tax-7.

[21] This tax-neutrality issue, which can involve either funds or fund managers, is discussed in Parts 2.B and 3 of Annex B and illustrated by Examples Tax-8 and Tax-9.

[22] This issue is discussed in Part 4 of Annex B.

Conclusion

ICI Global considers that the Passport has the potential to offer benefits to both investors and regulated fund managers in the participating countries. There is further work to be done but we appreciate and welcome the opportunity to provide our input for your consideration and look forward to working with you in further developing the Passport. We also support and encourage efforts to have other countries in the region join this initiative.

If you have any questions about our comments or would like additional information please contact Qiumei Yang, CEO, Asia Pacific (qiumei.yang@iciglobal.org or +852 2910 9225) or Giles Swan, Director of Global Funds Policy (giles.swan@iciglobal.org or +44 203 009 3103).

Yours faithfully,

/s/

Dan Waters
Managing Director

Annex A- Economic and Industry Objectives for the Development of the ARFP

The objectives for the Passport include strengthening both the capacity and competitiveness of the region's fund management industry, deepening markets and maintaining financial stability and efficiency. Over the past two decades, the global mutual fund industry has boomed, reaching $30 trillion by the end of 2013 (Figure 1). In the Asia-Pacific region, assets expanded more than 450 percent to US$3.4 trillion during that period.[23] We believe this Passport is well-timed to take advantage of factors that support, and are linked to, the growth of strong regulated fund markets and should help achieve the stated objectives for the Passport.

Enhanced Regulation and Cross-Border Funds

ICI Global analysis indicates that the demand for regulated funds is enhanced by a strong regulatory framework. The Passport Fund, by creating such a framework, would be expected to foster a stronger and larger regional industry; especially to the extent the passport region encourages cross-border fund growth. This regional Passport initiative fits well with the worldwide growth of cross-border funds, which more than doubled in number between 2002 and 2012 to more than 9000 funds worldwide (Figure 2).

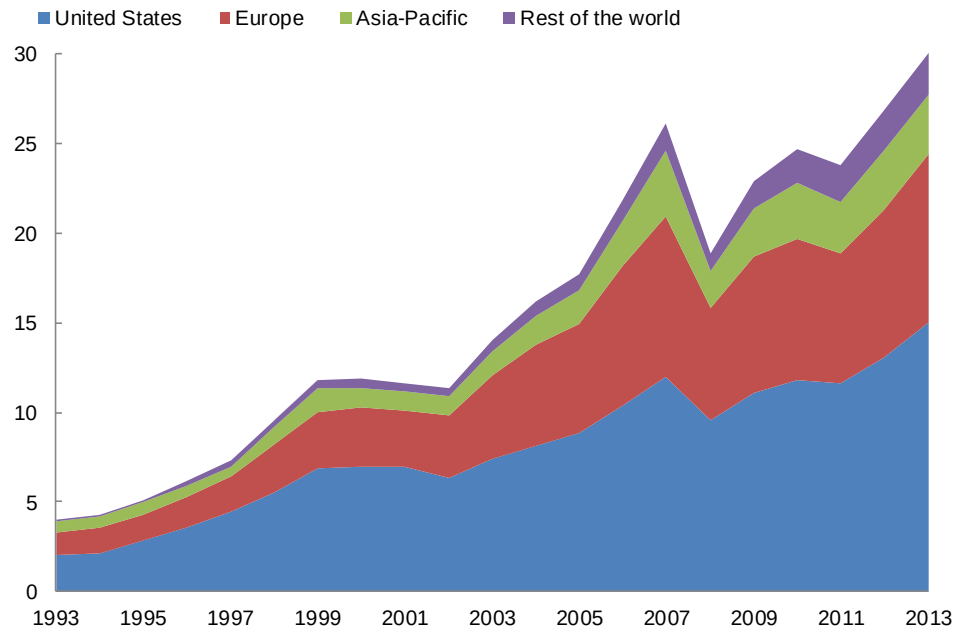
The Fund Passport Would Help Foster Fund Industry Growth

ICI Global research indicates that, among other things, the size of the long-term fund industry increases as a country's per capita GDP rises (Figure 3), as the depth and liquidity of its capital markets increases (Figure 4), and as the importance of defined contribution assets in that country grows (Figure 5).

In our estimation, these factors would be bolstered and enhanced in the APEC region by the Passport, although the effects are likely to vary by country. For example, the potential demand for regulated funds could rise rapidly in coming decades in the Philippines and Thailand as economic growth in these countries outpaces that in more developed regions. By contrast, in Australia and New Zealand, the ability of residents to invest in defined contribution plans that allow participant-directed investments, including in registered funds, may well drive growth over the next decade. Singapore and Hong Kong are currently active markets for cross-border funds primarily domiciled in the EU, which suggests that there is already an appetite for cross-border funds in APEC and that a regional passport could stimulate further APEC fund industry growth.

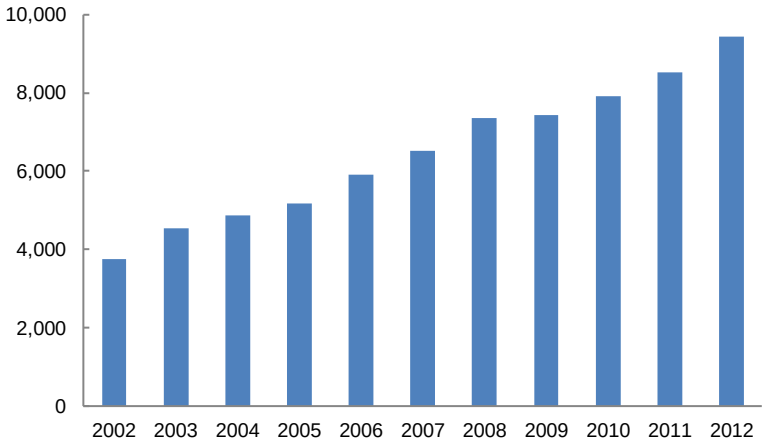
[23] See http://www.ici.org/research/stats/retirement/ret_13_q4

Figure 1
Worldwide Total Net Assets of Mutual Funds
Trillions of US dollars; year-end, 1993–2013



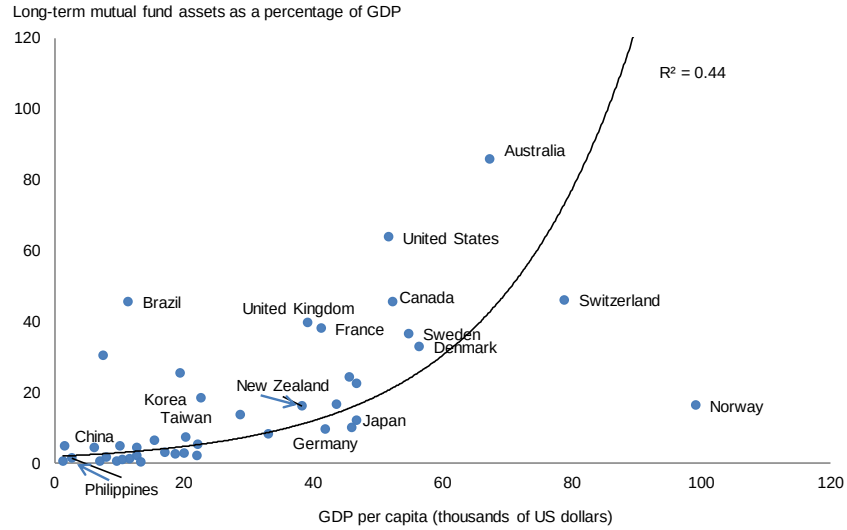
Note: Data include equity, bond, mixed/other, and money market funds. Funds of funds are not included except for France, Italy, and Luxembourg. Data include home-domiciled funds, except for Hong Kong, the Republic of Korea, and New Zealand, which include home- and foreign-domiciled funds.
Source: International Investment Funds Association

Figure 2
Number of Worldwide Cross-Border Funds
Year-end, 2002–2012



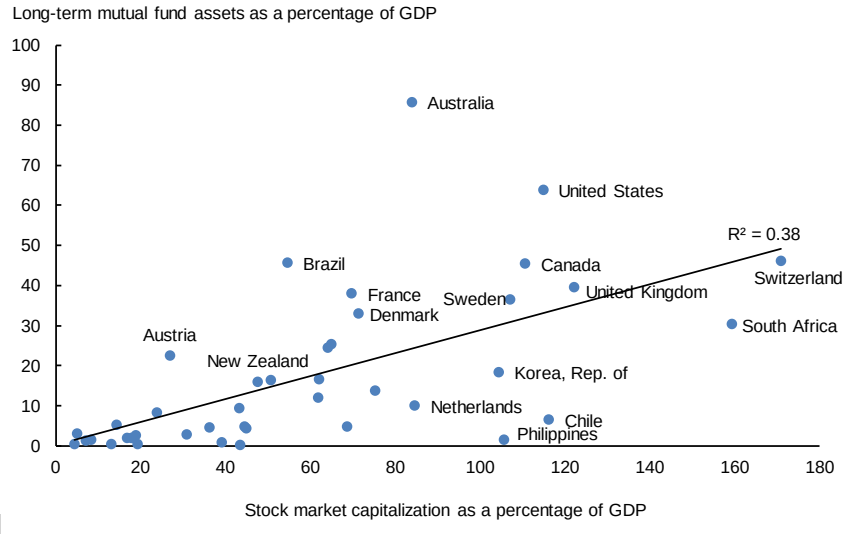
Sources: Lipper LMI and PwC

Figure 3
Fund Usage Increases with Per Capita Income
2012



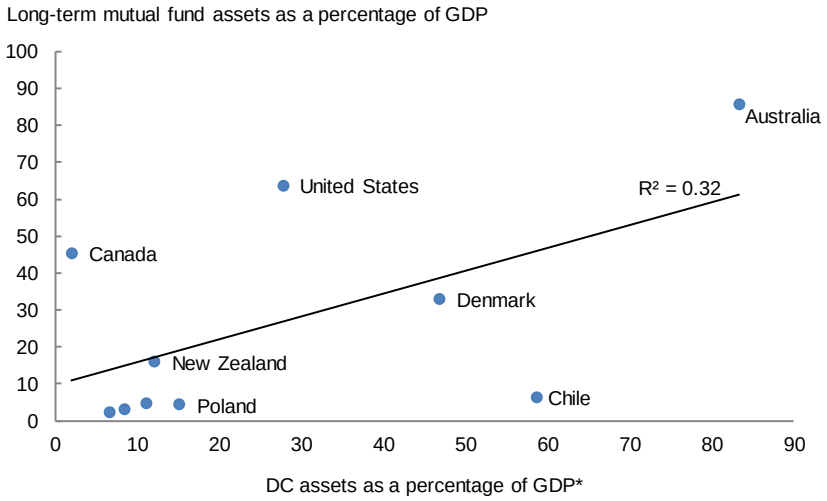
Note: Asset data for Russia is as of 2011; Luxembourg and Ireland are excluded.
Sources: International Investment Funds Association and International Monetary Fund

Figure 4
Countries with Larger Stock Market Capitalization to GDP Ratios
Have Larger Long-Term Mutual Fund Industry Asset to GDP Ratios
Percent, December 2012



Note: Total net asset data for Russia is as of 2011; Luxembourg and Ireland are excluded.
Sources: International Investment Funds Association and World Bank

Figure 5
Assets in Long-Term Mutual Funds Are Related to DC Plan Assets
Percent, 2012



*DC assets are 2011 OECD estimate.
Sources: International Investment Funds Association and OECD

Annex B – Tax Arrangements under the Asia Region Funds Passport

Tax issues will play a significant role in the success or failure of the Passport. Tax considerations for fund investors (directly and through the taxation of their funds) as well as fund managers must be addressed appropriately.

Tax neutrality should be an important priority. Specifically, the tax laws of neither the home nor the host country should provide investors with a tax incentive to favour one country's funds over another country's funds. Tax neutrality will prevent some markets from effectively being "off limits" to fund managers because their funds cannot compete from a tax perspective.

Equally important is tax certainty. Without certainty regarding the tax consequences of a fund portfolio investment, the price at which a fund's shares are purchased and sold (the net asset value ("NAV")) cannot be determined accurately. Tax certainty also provides fund managers with the confidence they need to enter markets and expand opportunities for investors.

Other tax considerations, such as effective treaty access for fund investors (including administrable procedural requirements), also are important. All of these issues are discussed below.

1. Tax Neutrality for Fund Investors

Tax can be one of the most significant costs for fund investors. These taxes can be incurred either directly (when the investor receives a distribution or sells shares) or indirectly (when the fund incurs withholding tax on cross-border investments and/or home-country tax on the income it receives). Tax issues impacting fund investors directly can arise in either the host country or the home country.

A. Tax Neutrality for Fund Investors Living Abroad ("Non-Resident Investors")

One fund-investor tax-neutrality principle is that a home country's tax regime should not discourage investment by host-country investors in a home country fund. Home country funds that seek to utilize the Passport for distribution purposes need the support of their governments on this issue.

Specifically, home country funds would be placed at a competitive disadvantage if non-resident investors in a local (Country A) fund incurred more local (Country A) tax than they would incur if they invested instead in a foreign (Country B) fund. This additional tax would be incurred if Country A treats all payments made by local funds to non-resident investors as having a local "source" and therefore as subject to Country A withholding taxes.

To prevent this result, Country A should provide "look-through" treatment for payments made by local funds to non-resident investors. The effect of this treatment would be to subject non-resident investors in a local fund to Country A withholding taxes only to the extent that these withholding taxes would be imposed had the non-resident investor instead invested directly or through a foreign fund.

Example Tax-1

Two funds – Fund A (local fund) and Fund B (foreign fund) – each distribute a dividend of 100*x* (*e.g.,* 100 Australian Dollars or 100 Korean Won) to a non-resident investor that is attributable to companies located in Country C. Assume that Country A treats the amount distributed as having a local source (since it was paid by a Country A fund) while

Country B treats the amount distributed as having a foreign source (since Country B "looks through" the fund and respects the source (local or foreign) of the fund's distributions). Further assume that each country imposes a withholding tax of 30% on payments to non-resident investors. In this example, a non-resident investor in the Country A fund would receive only 70*x* (after 30*x* was withheld as Country A tax) attributable to the Country C dividend while the non-resident investor in the Country B fund would receive the full 100*x*.

Example Tax-2

Fund A (local fund) and Fund B (foreign fund) each invest in a company located in Country A and receive, with respect to an investor resident in Country C, a dividend of 100*x*. When Fund A distributes the 100*x* dividend to the Country C investor, the fund imposes Country A withholding tax of 30*x*. This same amount is withheld by the Country A company when it pays its dividend to the Country B fund – because the Country B fund is a non-resident investor with respect to Country A. Thus, with respect to payments made by companies located in Country A, the Country A withholding tax regime is tax neutral. This tax neutrality exists, however, only to the extent that a Country A fund is investing in securities issued by Country A companies.

To provide non-resident investors with tax neutrality between local and foreign funds, local funds should be provided with "look-through" treatment with respect to the local or foreign source of their payments to non-resident investors. This tax neutrality also would benefit local funds that otherwise would be placed at a distinct competitive disadvantage when investing globally and seeking also to distribute globally.

B. Tax Neutrality for Fund Investors Living Locally ("Resident Investors"): The Roll-Up Fund Issue

A second fund-investor tax-neutrality principle is that a home country's tax regime should not encourage investment by home-country investors in host-country funds. Home country funds, whether or not they intend to utilize the Passport, need the support of their governments on this issue.

Specifically, home-country funds would be placed at a competitive disadvantage if resident (Country A) investors receive more favorable Country A tax results by investing in a foreign (Country B) fund than they would receive by investing in a Country A fund. This result would occur if Country A required its funds to distribute income currently but did not impose an "anti-deferral regime" that would tax its residents currently on income received, but not distributed, by a foreign fund. To prevent this result, Country A should either permit "roll-up" (income retention) treatment for its own funds or impose an anti-deferral regime on local investors in foreign roll-up funds.

An anti-deferral regime is intended to eliminate a local-law tax incentive for its local investors to prefer foreign roll-up funds over local distributing funds. One example of such a regime is the so-called passive foreign investment company (PFIC) regime imposed in the United States. Under an anti-deferral regime, approximate tax neutrality is achieved by either treating the local investor as having received the foreign fund's income currently or imposing an interest charge in addition to tax when the foreign fund shares are sold.

Example Tax-3

Country A taxes its residents at a 30% rate on dividends received and at a 15% rate on capital gains. Country A requires its funds to distribute income currently but does not impose an anti-deferral regime on its residents investing in Country B roll-up funds.

Fund A (local distributing fund) and Fund B (foreign roll-up fund) invest in the same securities and earn the same per-investment-unit amount of dividend income from their portfolios. Investor Z's share of this dividend income is 100*x* in each of five years (Years 1-5); Investor Z sells the fund shares on Day 1 of Year 6. Assume, for simplicity, that there has been no appreciation in the value of the funds' portfolio securities during this five-year period.

If Investor Z invests locally, in Fund A, the investor will incur a Country A tax of 30*x* in each Year (1-5) because Fund A is required to distribute its dividend income to its investors in the year received. By investing in Fund B, however, Investor Z would incur no Country A tax in Years 1-5 because Fund B is not required by Country B laws to distribute its income and Country A does not have an anti-deferral regime in place.

When Investor Z redeems the fund shares on Day 1 of Year 6, the investor will not incur any Country A capital gains tax because all of the Fund A income would have been distributed by the end of Year 5 (and there has been no capital appreciation in this example). By investing in Fund B, however, Investor Z would incur Country A capital gains tax on the 500*x* of dividend income that was not distributed by Fund B.

To summarize, Investor Z would incur 30*x* of tax in each of Years 1-5 (total tax liability of 150*x* by investing in Fund A) but only 75*x* of tax (15% capital gains tax on 500*x* of gain attributable to retained income) by investing in Fund B.

When an investor can choose between investing in a local distributing fund and a foreign roll-up fund, two separate tax advantages can be realized by investing in the foreign roll-up fund. First, tax can be deferred; tax deferral provides an additional benefit because the untaxed amounts can continue to generate additional returns. Second, when tax is due on the sale of the fund shares, the gain can be taxed at preferential, lower capital gains tax rates rather than at higher "ordinary" income tax rates.

To prevent this result, Country A should either allow its funds to retain their income and gains or instead impose an anti-deferral regime on its residents' investments in foreign roll-up funds. These alternative approaches are illustrated in the examples below.

Example Tax-4– Country A's Roll-Up Treatment for Country A Funds

The facts are the same as in Example Tax-3 except that Country A allows roll-up treatment for Country A funds. In this Example Tax-4, Investor Z will not incur any tax until the Fund A shares are sold in Year 6. At that point, Investor Z will owe 75*x* of Country A tax – which is the same tax that would be due (at the same time) by investing instead in Fund B.

Example Tax-5 – Country A's Anti-Deferral Tax on Country A Investors in Roll-Up Funds

The facts are the same as in Example Tax-3 except that Country A imposes an anti-deferral regime on its residents' investments in foreign roll-up funds. Under an anti-deferral regime that marks to market the interests in a foreign roll-up fund, Investor Z in

this Example Tax-5 would incur *30x* of tax each year on the investment in Fund B. Thus, the investor would be tax-indifferent between Fund A (as tax is imposed at a 30% rate on the 100*x* that is distributed each year) and Fund B (as tax is imposed at a 30% rate on the 100*x* of mark-to-market gain attributable to amounts retained each year).

If a country chooses to require that its funds distribute, rather than retain, their income, anti-deferral rules are essential to prevent local funds from being less attractive to local investors than foreign roll-up funds.[24] It also is important, however, to maximize the extent to which these rules in fact are tax-neutral. An anti-deferral regime should strive to impose the same tax on an investor whether the investment is in a local distributing fund or a foreign roll-up fund; if the investor in the foreign roll-up fund is taxed disproportionately heavily (such as because unrealized gains are taxed only in the foreign roll-up fund), the regime causes local funds to be favoured.

C. Tax Neutrality for Fund Investors Living Locally ("Resident Investors"): The Local Tax Preferences Issue

A third fund-investor tax-neutrality principle is that a home country's tax regime should not provide tax incentives for investment by home-country investors in home-country funds. Host-country funds that seek to utilize the Passport may need their governments to encourage any home country with this type of tax regime to either repeal it or modify it substantially.

Specifically, foreign (Country B) funds would be placed at a competitive disadvantage if resident (Country A) investors receive more favorable Country A tax results by investing in a local (Country A) fund than they would receive by investing in a foreign (Country B) fund. This result would occur if the investors' country provided tax preferences (such as a capital gains exclusion) for investments in local funds that were not expressly available if the investment were made instead in a foreign fund.

To prevent this result, any country that wants to encourage investment in domestic securities should provide expressly that its investors may look through funds (whether local or foreign) to determine the extent to which income and gains receive tax preferences. This "look through" treatment, however (and as discussed in detail below), could require complex calculations.

Example Tax 6

Country A exempts from tax the capital gains realised by Country A investors from Country A securities. Capital gains arising from the securities of other countries (Countries B-ZZ), however, are taxable when realised by Country A investors.

Fund A (local fund) and Fund B (foreign fund) each invest 100% of their assets in securities of Country A and distribute capital gains of 100*x* to Investor Z (who is a taxpayer in Country A). All of the gain is attributable to securities from Country A and would be exempt if received directly by a Country A taxpayer.

Investor Z's investment in Fund A is fully exempt from Country A capital gains tax. This result occurs because Country A's laws provide expressly that a Country A fund is tax transparent for this purpose and all of Fund A's investments are in Country A

[24] Australia and New Zealand, for example, have the proposed Foreign Accumulation Funds (FAF) and/or Foreign Investment Fund (FIF) rules which are similar to the US PFIC rules discussed above.

securities. The same (tax-exempt) result will occur when Investor Z redeems the Fund A shares.

Investor Z could face a significant tax disadvantage, in this example, by investing in Fund B unless the laws of Country A expressly provide the same look-through treatment for foreign funds. First, all of the capital gains distributed to Investor Z – that would be exempt from capital gains tax if realised directly (because they are attributable to Country A securities) – may be taxable because they are received from the "foreign" Fund B. Even if "look through" treatment were provided for distributions, Investor Z still would prefer Fund A over Fund B unless the gain from the sale of Fund B shares were treated as Fund A capital gains; "look through" treatment for fund share gains would be simple in this Example 6 as the fund invests only in one country.

On the facts in Example Tax 6, Investor Z could have a very strong tax preference for the Country A fund – even when the Country A and Country B funds invest in exactly the same portfolio securities. This preference exists unless Country A's laws expressly provide both Country A and Country B funds with comparable tax treatment (that could be administered effectively by Country B funds). Without *express* guidance, *any* uncertainty on such an important tax issue would provide Investor Z with a very strong tax preference for the Country A fund.

Example Tax 7

Example Tax 7 is the same as Example Tax 6 except that each fund invests in both Countries A and B – and the proportionate investment in each country varies widely on a year-by-year basis. Moreover, while each fund sells some Country A and Country B securities each year, other highly-appreciated Country A and Country B securities remain in the portfolio.

Investor Z, once again, has a strong tax preference for Fund A unless the look-through rules for the Country B fund are provided expressly in Country A's tax laws.

Significant tax neutrality issues will arise for the Passport if a country provides a capital gains tax exemption for gains realised by its investors from local securities, but imposes such a tax on gains arising from foreign securities. For tax neutrality between home and host funds to be maintained in this tax regime, two distinct issues must be addressed.

First, all funds must be treated as tax transparent with respect to the source of any capital gains that they distribute. To properly account for the source of distributed gains, a fund in the examples above would need to: (1) track separately the gains from Country A securities vis-à-vis gains from all other securities; and (2) determine, when gains are distributed, the extent to which the gains are attributable to Country A securities.

This accounting would be fairly straightforward in Example Tax 6 because the funds' invest exclusively in a single country. Thus, all of the gains distributed by Funds A and B would be exempt from tax in Example Tax 6.

The accounting required in Example Tax7, in which a changing proportion of each fund's assets is invested in Country A securities, is more extensive. Specifically, in addition to the two accounting steps discussed immediately above, any fund making multiple distributions during a year would need to report precisely the sources of each capital gains distribution as some taxpayers might be investors in the fund for only one of the distributions.

Second, the gain from the sale of fund shares must be treated as exempt to the extent attributable to gains (whether (1) unrealised by the fund or (2) realised but not distributed). This treatment would result in all sales proceeds of Fund A and Fund B shares being exempt from tax in Example Tax 6. Determining the portion of any gain on the sale of Fund A and Fund B shares in Example Tax 7, however, would be complex (at best).

Specifically, the steps required to compute exempt sales proceeds in Example Tax 7 would include the two steps discussed immediately above – (1) tracking separately the gains from Country A securities vis-à-vis all other securities; and (2) determining, when gains are distributed, the extent to which the gains are attributable to Country A securities – as well as (3) determining the proportion of realised, but retained, gains that are attributable to Country A securities (as these gains effectively will be part of any gain realised by Investor Z when the fund shares are sold) and (4) determining the proportion of net unrealised gains (the difference between unrealised gains and unrealised losses) that are attributable to Country A securities. To accomplish these steps, every fund distributing in Country A effectively could be required to track continuously the realised and unrealised gains from its securities in every country. Moreover, to the extent that precision is the goal, steps three and four would need to be performed *every* day as securities are sold, as securities are purchased, and as the value of the portfolio securities change.

Obviously, the simplest solution to this very problematic tax barrier – from an effectiveness-of-the-Passport perspective – would be for Country A to repeal any tax rule that is designed to encourage Country A taxpayers to invest in Country A securities. If these rules are not repealed, some administrable and consistently applied rule for determining the portion of any gain on the sale of fund shares would be needed. One approach would be to determine the applicable portion of fund share sales proceeds that would be deemed attributable to Country A at (or even before) the beginning of each year (based upon the steps discussed above); this deemed percentage would apply to all shares of that fund that taxpayers sold during the year.

2. Tax Neutrality for Funds

A. Direct Investment Comparability

One fund-specific tax-neutrality principle is that investors should not incur more tax by investing in a fund than they would by investing directly in the fund's portfolio securities. In practice, this principle requires that funds not incur tax on their investments (other than cross-border investment withholding tax that also would be incurred by direct investors in the same cross-border investments). If funds pay tax on their income, and then fund investors pay tax when they either receive fund distributions or sell fund shares, this "extra" fund-level tax will make the funds uncompetitive. This principle sometimes is referred to as the "direct investor" comparison; fund investors should be provided with tax treatment that is comparable to that of a direct investor.

To ensure "direct investor" comparability, home countries should not impose home-country tax on funds' portfolio income and gains – whether the funds are organized in the home country or in another country. This comparability generally is provided by exempting funds from all home-country tax or by providing funds with a tax deduction for all distributions to investors. Either of these approaches effectively limits the fund investor's tax consequences to the receipt of fund distributions or the disposition of fund shares.

B. Source-Country Taxation

A second fund-specific tax-neutrality principle is that a country in which a fund invests (a source country) should not treat foreign funds as local funds merely because they: (a) invest in the source country's securities; or (b) are managed by an adviser that uses a subsidiary or independent agents to distribute fund shares or conduct other business. These activities, as discussed below, do not cause the fund to have a taxable presence (a "permanent establishment" or "PE") in a country other than the one in which it is organized. PE is the concept used to determine the right of one country to tax the profits of an enterprise in another country.

Treating foreign funds as local funds would make foreign funds less likely to invest in the local markets because of the attendant tax obligations of having "local fund" status. These tax obligations could include tax filing requirements, satisfaction of local rules to qualify for "direct investor comparability" tax treatment,[25] and/or local tax liabilities.

If foreign funds are treated as local funds, both investors and issuers will be harmed. Specifically, the tax cost of investing in a local market that treats foreign funds as local funds will increase and, consequently, will make foreign investors less interested in investing in the local market through foreign funds. As a consequence, local issuers seeking to attract foreign investment likely will suffer as well.

Example Tax-8

Country A imposes a 30% tax on the income of funds deemed to be domiciled in Country A and exempts from tax the amounts distributed by these funds to their investors. Country A also imposes a 25% withholding tax (reduced by treaty to 15%) on the Country-A-source-income that is paid to foreign funds.

Country B exempts its funds from fund-level tax whether or not they distribute their income. The Country B fund, consequently, retains its income.

Country B fund is managed by a company that hires a subsidiary in Country A to recommend Country A securities.

Country A has a very expansive view of what activities constitute a PE. This expansive view causes a Country B fund to be deemed to have a taxable presence in Country A.

Country B fund receives 10,000*x* of portfolio investment income, only 2,000*x* of which is attributable to Country A securities. If Country A treats the Country B fund as a local fund, the fund's Country A tax liability is 3,000*x* (30% of 10,000*x*) because the Country B fund does not satisfy the Country A distribution requirement. If Country A instead treats the Country B fund as a foreign fund, the fund's Country A tax liability is either 500*x* (25% of the 2,000*x* attributable to Country A securities) if the fund is not eligible for the treaty relief or 300*x* (15% of 2,000*x*) if the fund is treaty-eligible.

[25] A fund organized in a country that provides a fund-level tax exemption for roll-up funds, for example, would suffer fund-level tax were it treated as a local fund in a country that requires annual distributions of a fund's income.

To ensure tax neutrality, foreign funds making portfolio investments – or being distributed to local investors – should not be treated as local funds irrespective of whether or not the fund manager has a subsidiary or independent agent on the ground.

To achieve this tax-neutral result, APEC countries should follow the OECD standard for finding a PE; this standard is provided by Article 5 of the OECD Model Income Tax Convention and the accompanying Commentary. Under Article 5, a PE involves a fixed place of business through which the business of an enterprise is wholly or partly carried on. Paragraph 7 of Article 5 provides that the existence of a subsidiary company, in itself, does not, cause that subsidiary to be a PE of the parent company. Even the fact that the business carried on by the subsidiary is managed by the parent company does not cause the subsidiary to be a PE of the parent company. The subsidiary will be treated as a PE of the parent company in various situations – including if the subsidiary has, and habitually exercises, a right in that country to execute contracts in the name of the parent. In no case, however, should the activities of a subsidiary or independent agent of the fund manager cause the fund itself to be treated as having a PE in a country other than the one in which it is organized.

3. Tax Neutrality for Fund Managers Operating Globally

Tax neutrality also is necessary for fund managers. A fund manager that invests, and/or distributes fund shares, in a foreign country should not be treated as having a PE in the country merely because it invests, or distributes its shares, in that country through subsidiaries or independent agents. Instead, the fund manager should be treated as operating in the country in which its management activity (*e.g.,* senior management activities, legal operations, portfolio management decisions, etc.) take place; this also is the location of the "entrepreneurial risk" to which the company's profits are attributable. All income of the subsidiary or independent agent will be taxed where these parties have PEs.

Example Tax-9

Fund Management Company (FMC) is organized and operates in Country A; FMC has 500 employees who perform services (including the management, portfolio selection, and compliance) for FMC's funds. FMC files tax returns, and pays corporate income tax, in Country A.

To expand its business, FMC organizes a subsidiary service company (SSC) in Country B to provide investment advice and to facilitate distribution of FMC's funds; SSC employs ten people in the year at issue. FMC compensates SSC on an arm's-length basis for these services. FMC receives a deduction in Country A for its payments to the Country B SSC. In the tax year at issue, 5% of the shareholders in FMC's funds reside in Country B.

Country B asserts that both SSC and FMC have PEs in Country B that subject both companies to Country B corporate tax (including obligations to file tax returns). Country B asserts that 5% of FMC's gross income should be allocated to Country B because 5% of the FMC funds' shareholders reside in Country B. As FMC does not have any employees in Country B, it's only Country B expenses are the payments that it makes to SSC. Country B's assertion of tax against FMC effectively results in 5% of FMC's income being taxed in both Country A and B – unless Country A respects Country B's expansive assertion of taxable presence. Moreover, because all of FMC's activities (and expenses, other than the fee paid to SSC) take place in Country A, the effective tax rate on the 5% of FMC's income that is treated as taxable in Country B is very high.

To prevent this double tax result, all APEC countries should follow the OECD's guidance regarding permanent establishment. Under these rules, as discussed above, the worldwide profits of an offshore entity are not taxed solely because of the activities of a subsidiary or an independent agent. The guidance provided by the Commentary to Paragraph 7 of Article 5 is clear. Paragraph 40 of the Commentary, for example, provides that "[e]ven the fact that the trade or business carried on by the subsidiary company is managed by the parent company does not constitute the subsidiary company a permanent establishment of the parent company." Other factors, such as the subsidiary habitually exercising an authority to conclude contracts in the parent's name, are necessary to establish a PE for the parent.
The local country nevertheless will be able to tax fully the activities of the subsidiary or independent agent operating within its borders. Specifically, the local entity will receive a fee (such as one calculated on an arm's-length cost-plus basis) for the services that it provides to the foreign entity. Any concerns about the appropriateness of the fee can be addressed by local tax authorities through an audit adjustment. Importantly, any such adjustment would not involve finding a PE where one does not exist.

4. Effective Opportunity for Fund Investors to Claim Treaty Relief

Fund investors, as intended beneficiaries of withholding tax reductions contained in treaties negotiated by their governments, should have effective mechanisms for claiming that relief through their funds. This relief consists of reduced source-country withholding tax on dividends (and sometimes interest and/or capital gains); for example, if the withholding tax rate provided by statute is 30 percent and the treaty rate is 15 percent, a treaty can reduce the tax cost of cross-border investment by 50 percent.

To achieve this result, APEC countries should apply the recommendations of the Collective Investment Vehicle (CIV) Report[26] and Treaty Relief And Compliance Enhancement (TRACE) implementation package that were developed by the Organisation for Economic Co-operation and Development (OECD).[27] These two documents were developed following extensive consultations between governments, the OECD Secretariat, and business representatives.

The CIV Report provides mechanisms for all funds, regardless of their form of organization, to claim withholding tax relief provided by treaties for their investors. The mechanisms allow funds that satisfy the requirements to claim treaty relief in their own right to do so. For funds that do not meet these requirements, the CIV Report provides mechanisms for the funds effectively to claim treaty relief on behalf of their investors. These mechanisms include administrable rules for demonstrating tax treaty eligibility of a fund's investors. As taxes can be a significant cost for investors, the ability to claim treaty relief can be an important factor in encouraging fund investment.

The TRACE implementation package provides administrable procedures that maximize the ability of intermediaries to claim treaty benefits for their customers (including funds) at the time the income (*e.g.,* dividends) is received from source-country payers. At-source treaty-rate withholding is particularly beneficial for fund investors because of the certainty provided for the calculation of the price (NAV) at which fund shares typically are purchased and sold. Knowing with certainty the source-country tax liability ensures that the NAV is calculated correctly and, therefore, that daily investor purchases and sales are transacted at the correct price.

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[26] The CIV Report more precisely is entitled "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" and is available 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).

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

5. Appropriate Application of Tax Reporting Rules

Tax compliance considerations have gained significant prominence since the United States enacted the Foreign Account Tax Compliance Act (FATCA) in 2010. In January 2014, the OECD approved a Common Reporting Standard (CRS) under which financial institutions will provide tax information about nonresident customers to their local governments; the governments, in turn, will exchange that information automatically with other countries participating in the CRS. Four of the six countries participating in this consultation, as well as other countries in the Asia-Pacific region, announced their support for the CRS in April 2014.[28]

ICI Global supports these efforts to ensure tax compliance. It is imperative, however, that these rules be administrable. We have worked closely with the US government on FATCA and with the OECD and its member governments on the CRS and Commentary to maximize the benefits of these rules to governments while minimizing the attendant burden on the business community.

We strongly encourage APEC countries that adopt the CRS to apply it consistently. The tax burden of utilizing the Passport will increase if fund distributors must apply different rules in each country for determining the tax residence of fund investors and for reporting customer information to tax authorities.

6. Appropriate Application of "Anti-Abuse" Provisions Targeted at Multinational Enterprises

Other tax issues that have gained significant global prominence recently involve tax strategies employed by multinational enterprises. To address these concerns, the OECD in 2013 announced the Base Erosion and Profit Shifting (BEPS) initiative[29] and the 15-point BEPS Action Plan.[30]

ICI Global supports the OECD's role in addressing on a coordinated basis various important tax concerns. We also recognize that specific concerns – such as tax treaty abuse and hybrid mismatch arrangements – can be serious problems for governments. In general, we submit, the concerns raised by BEPS do not involve funds.

We strongly encourage APEC members that participate in the BEPS initiative and/or subsequently adopt the OECD's recommendations take into account the differences between funds and the multinational enterprises that are the primary target of the BEPS Action Plan items. To that end, ICI Global filed comments with the OECD on BEPS Action 6 (tax treaty abuse)[31] and BEPS Action 2 (hybrid arrangements).[32] These comments, which were received favorably by the OECD Secretariat, suggested changes to prevent fund investors from being harmed inadvertently by initiatives designed at abusive activities.

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28 http://www.oecd.org/mcm/MCM-2014-Declaration-Tax.pdf.
29 http://www.oecd.org/tax/C-MIN(2013)22-FINAL-ENG.pdf.
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