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taxtreaties@oecd.org  
Tax Treaties, Transfer Pricing and Financial Transactions Division  
Centre for Tax Policy and Administration  
Organisation for Economic Co-operation and Development  
Paris, France

April 1, 2016

Dear sir/madam,

With this letter, the parties signed below are responding to the OECD's invitation to provide comments with respect to the discussion draft on changes to the OECD Model Tax Convention (the "**Model Tax Convention**") concerning the treaty residence of pension funds (the "**discussion draft**"), released on February 29, 2016.

This letter is prepared by an informal coalition of global pension funds, which has decided to collaborate on preparing this joint submission to provide constructive input on the OECD's work to secure treaty access for the long-term benefit of pension funds and their beneficiaries. With combined assets under management of approximately 1.5 trillion USD, this group is representative of a larger global constituency of pension funds that manages the retirement security of citizens from countries around the world and also provides investment capital to drive economic growth in a number of developed and emerging economies.

We have previously responded to invitations from the OECD to provide comments in relation to items that are of considerable relevance to pension funds and their pension beneficiaries.<sup>1</sup> As such, we welcome and value that the OECD has again reached out to interested parties to continue the constructive dialogue on the tax treatment of pension funds worldwide. We consider this additional work to ensure that a pension fund should be considered a resident of the State in which it is constituted for tax treaty purposes to be of great importance and have therefore decided to provide you with our joint comments and observations below.

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<sup>1</sup> Reference is made to the previous submission dated June 17, 2015 in relation to the Revised Discussion Draft on BEPS Action 6 released May 22, 2015, and the three separate submissions all dated January 9, 2015 submitted by the Canadian parties to this letter, by the Dutch parties and by the Australasian Parties (in this letter referred to as the "Canadian Submission", the "Dutch Submission" and the "Australasian Submission" respectively, and collectively, as our "Submissions").

## 1. Comments requested by the OECD

The OECD has invited comments in particular to several phrases included in the definition of a recognised pension fund. Below we will respond to the OECD's invitation in the same order as in the discussion draft.

### 1.1. As regards the phrase “that is treated as a separate person under the taxation laws of that State”

As recognized by the OECD in the draft Commentary on Articles 3 and 4 of the Model Tax Convention, there is considerable diversity in the legal and organizational characteristics of pension funds around the world. It is important that the pension fund definition which is scheduled for adoption by the planned revision to the Model Tax Convention appropriately captures the diverse range of such organizations. We agree that the reference to an “*entity or arrangement established in that State that is treated as a separate person*” should be interpreted in a broad manner, although we are concerned that the addition of the term “separate” may introduce a new concept that may be difficult for some entities to demonstrate in a way that would satisfy all OECD Member States.

To avoid certain types of pension fund organisations being put at risk of not qualifying for the definition of a recognised pension fund, we suggest that the proposed wording of paragraph 1 of Article 3 is aligned for consistency with the wording currently used in Article 3 and Article 4 of the Model Tax Convention, which does not require a person to be a “separate” person. Also Article 3, paragraph 1, subparagraph k) of the 2016 US Model Tax Convention refers to a pension fund as “*any person established in a Contracting State (...)*”.

We are confident that even with the omission of the word “*separate*” the phrase should sufficiently address situations in which income of a pension fund may be treated as income of another person for tax purposes, considering that the definition requires that entity or arrangement to be considered a person “*under the taxation laws of that State*”. Furthermore, the conditions set out under subsections (i) and (ii) of paragraph 1, subparagraph j) of Article 3 make sure that only entities or arrangements exclusively (or almost exclusively) providing retirement benefits should be in scope of the definition of a recognized pension fund. As such, it would not be possible for persons which partially carry out some pension activities to be considered a recognized pension fund.

Paragraph 10.4 of the draft Commentary refers to trust-like vehicles and arrangements which may not be considered an entity under the applicable legislative framework, albeit that such a vehicle may be considered a separate person for tax purposes in its own right or by virtue of the qualification for tax purposes of its body of trustees. We are concerned that this sole example may not sufficiently illustrate the breadth of arrangements that exist under the legal frameworks of the numerous OECD Member States and that in practice, referencing only a single example may mean that the definition is applied in a narrow manner. Therefore, we recommend amending the Commentary to include additional examples, such as superannuation funds, government sponsored pension schemes designed for its citizens, UK trusts and other dedicated trusts/funds as follows (with addition in **bold underline**, deletion in ~~strikethrough~~):

*10.4 (...) The reference to an “arrangement” is intended **amongst other things** to cover cases where pension benefits are provided through vehicles such as a trust **or any other arrangement** which, under the relevant ~~trust~~ law, would not constitute an entity **(such as a superannuation fund or certain government funds constituted to provide retirement benefits)**: the definition will apply as long as ~~the trust or the body of trustees is treated~~, for tax purposes, **that trust (or its body of trustees) or (an entity within an) arrangement is treated** as a separate entity recognised as a separate person. It is required, however, that the entity **or (entity within an) arrangement** be treated as a separate person under the taxation laws of the State in which it is constituted: if that is not the case, it is not necessary to deal with the issue of the residence of the pension fund itself as the income of that fund is treated as the income of another person for tax purposes.*

In addition, within some pension arrangements a separation takes place between entities or arrangements that provide or effect the pension benefits and entities or arrangements that hold the funds invested on behalf of the pension beneficiaries. A further clarification in the Commentary would be welcomed in this respect to ensure that such pension arrangement is considered a recognized pension fund as defined in

Article 3, paragraph 1, subparagraph j) under (i) of the Model Tax Convention. A similar set-up may for example be used by certain government funds constituted to administer or provide retirement benefits for beneficiaries of that State or local subdivision thereof, where the actual provision of those benefits to individuals may be effected indirectly by another part of the government. We recommend that it is clarified that the mechanics of the manner in which retirement benefits are paid out to the beneficiaries or the separation between holding the funds invested on behalf of the pension beneficiaries and paying out the benefits should not hinder the qualification of such fund as a recognized pension fund of the State in which it is constituted.

### **1.2. As regards the phrase “that is constituted and operated exclusively to administer or provide retirement or similar benefits”**

The OECD has invited comments on whether the word “exclusively” would be too restrictive given the normal operations of a pension fund. Pension funds often have other activities which are complementary or related to the main activity of administering or providing retirement benefits or similar benefits and may also perform activities which are outside the strict scope of providing these types of benefits. Such activities often serve a social and public purpose, but not all OECD Member States may capture these activities under the phrases “providing retirement benefits” or “similar benefits”.

By requiring a pension fund to operate exclusively to administer or provide retirement or similar benefits, pension funds that also perform activities of which it is unclear whether these activities may be considered equivalent or similar to that purpose would be excluded from the definition of a recognised pension fund. We therefore suggest that this phrase is amended in accordance with Paragraph 12 of the final version of the Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances), as follows: “*that is constituted and operated exclusively or almost exclusively to administer or provide retirement or similar benefits*”. By rephrasing this sentence in this manner, a recognised pension fund would still be required to operate with the purpose of administering or providing retirement benefits or similar benefits, but would allow for some leeway for relatively small activities that are subordinated to the main purpose of providing retirement benefits (we will address such activities below under section 1.3.).

The wording “exclusively or almost exclusively” would also tie in with the definition of a pension fund included in Article 3, paragraph 1, subparagraph k) of the 2016 US Model Tax Convention, whereby a pension fund is considered “*any person established in a Contracting State that is (...) operated exclusively or almost exclusively a) to administer or provide pension or retirement benefits or similar benefits (...)*”.

Furthermore, there are examples of OECD Member States with a large pension sector where the specific pension fund provisions included in the respective legislative framework also allow for some leeway in view of activities that can be performed by pension funds. For example, the Dutch exemption from corporate income tax applicable to pension funds can only be applied if a pension fund meets several tests, one of which being a “purpose test”. Under this purpose test, the objective of a pension fund should be to operate exclusively or almost exclusively to provide benefits for the care of (former) employees in case of disability or old age, based on a pension scheme.<sup>2</sup>

### **1.3. As regards the phrase “similar benefits”**

The draft Commentary in relation to the purpose of a recognized pension fund to administer or provide retirement or similar benefits to individuals, as included in paragraph 10.5, properly reflects the primary objective of pension funds worldwide. First of all, we appreciate that the OECD aims to make the definition of a recognized pension fund and the Commentary thereto broadly applicable, so that the main forms of pension funds that currently exist are covered. In this respect, the acknowledgement in paragraph 10.5 that a pension fund can include a self-employed individual is a helpful reference since many government sponsored pension funds will not only support individuals that were employed by a third-party but also individuals that are self-employed. Such plans support a wide citizenry of a country, where the entitlement to benefits is based on the locally defined concept of pensionable earnings. Also, both government

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<sup>2</sup> Unofficial translation of an excerpt from Article 5, paragraph 1, subsection b. of the Dutch Corporate Income Tax Act 1969.

sponsored and single employer pension funds may provide pension benefits for directors and officers of a company. None of these factors should disqualify a pension fund from being considered a ‘recognized pension fund’. Therefore, it would be advisable for the Commentary included in paragraph 10.5 to be expanded to provide a more complete reference to the self-employed (more than that of a single individual), corporate officers who are not employees, non-executive board members and other persons who would not be considered common law employees of an employer.

Furthermore, the examples provided by the OECD in paragraph 10.5 of the draft Commentary on what can be considered “similar benefits”, such as payments made as a result of the death or disability of an individual, in our view accurately describe activities carried out by pension funds that should be considered in line with providing retirement benefits. Considering that the definition is intended to cover many different forms of pension funds we anticipate that the term “similar benefits” should be interpreted broadly, so that it for example also covers payments for the benefit of surviving members of the family of the deceased (widow and orphan benefits), etc. For example in Germany the corporate income tax exemption for pension funds as provided for under §5 (1) Nr. 3 b of the Körperschaftsteuergesetz relies upon the requirement (amongst others) that the pension fund is according to its business plan and the manner and amount of the benefits considered a social institution. This involves benefits provided on the basis of old age, disability, as well as benefits for the surviving members of the family. Furthermore, as mentioned in the final sentence of section 1.2. above, the Dutch corporate income tax act also includes disability, widow and orphan benefits as similar benefits.

In practice, pension funds may also perform activities outside the strict scope of their main purpose of administering or providing retirement benefits, albeit that such activities are often relatively small in size compared to the main activity of providing retirement benefits. Furthermore, such activities often have a social welfare angle and may be considered of importance to the public and to pension beneficiaries. In view of the foregoing, we value that the OECD has welcomed examples of “benefits” that may be granted by pension funds that some OECD Member States may neither consider “retirement benefits” nor “similar benefits”, as it is clearly not intended that pension funds granting such benefits would not be considered a recognized pension fund. There are different approaches by OECD Member States as to whether granting such benefits would be considered “similar” to providing retirement benefits, however granting such benefits would generally not disqualify a pension fund from being considered as such under the applicable legislative framework. This is why many OECD Member States allow for some capacity to provide benefits other than retirement benefits (for example by incorporating an “almost exclusively” requirement in the applicable pension legislation, as mentioned under 1.2. above) and maintain a broad definition of what is considered “similar” to providing retirement benefits. A clear break between activities that would be considered “similar” benefits and activities that would fall under “almost exclusively” cannot easily be made as there is overlap and as there is no consistent approach by OECD Member States in this respect.

Activities that may be considered similar to providing retirement benefits by some OECD Member States are for example providing healthcare packages, activities related to providing affordable housing, worker’s compensation program benefits, administrative services in the field of occupational health, allowing for amounts to be withdrawn and lent to cover major expenses of a beneficiary such as unexpected medical costs, etc. These examples are not meant to be limitative or exclusive. Furthermore, some of these activities may be embedded in such a manner within the primary service of providing retirement benefits that pension beneficiaries would consider these additional services indisputably part of their retirement packages.

Of course, as suggested under 1.2. above, the addition of the term “almost exclusively” would also provide for proper scope to capture the majority of the pension funds that currently exist. The addition of “almost exclusively” would also ensure that pension funds should only fall within the scope of the definition of a recognized pension fund if the purpose is to administer or provide retirement or similar benefits, whereby only ‘other activities’ that are relatively small in size and clearly subordinated to the main activity of providing retirement benefits would be permissible. To ensure a broadly applicable pension definition that closely relates to the general treatment of pension funds in OECD Member States, we therefore suggest incorporating “almost exclusively” in the definition of a recognized pension fund as suggested in 1.2. above and to expand the Commentary in paragraph 10.5 to include more examples of what may be considered “similar benefits”.

As a final remark in relation to paragraph 10.5 of the draft Commentary, we suggest replacing the term “invalidity” as mentioned in the final sentence of this paragraph by the term “disability”. The term disability may be considered more appropriate to address the consequences of impairments of a physical or mental nature.

#### **1.4. As regards the phrase “that is constituted and operated exclusively to invest funds for the benefit of entities or arrangements (...)”**

We appreciate that the OECD has also included entities and arrangements that are constituted and operated to invest funds for recognized pension funds within the definition of a recognized pension fund for the purpose of the OECD Model Convention. We concur with paragraph 10.8 of the draft Commentary, whereby it is recognized that pension funds often invest together with other pension funds pooling their assets in certain arrangements or entities, or may for example invest via wholly owned entities or arrangements resident in the same State for commercial, legal or regulatory reasons.

The word “exclusively” within this context may be too restrictive for certain cases in which countries have overseas territories which can be considered separate jurisdictions. If a pension fund resident in such overseas territory invests via an entity or arrangement together with a pension fund in the “main” jurisdiction, treaty benefits may be denied to such investment entity or arrangement. As pension funds resident of such overseas territories are often relatively small compared to pension funds in the main jurisdiction, it may be appropriate to insert “almost exclusively” in Article 3, paragraph 1, subparagraph j) under (ii) of the Model Tax Convention.

## **2. Other comments**

Below we will outline our further comments in relation to the discussion draft.

### **2.1. As regards the Proposed changes to paragraph 1 of Article 4 of the Model Tax Convention**

It has been suggested in the discussion draft to amend paragraph 1 of Article 4 of the Model Tax Convention in order to include recognized pension funds as resident of a Contracting State for purposes of the Convention. Article 4 of the Model Tax Convention describes a resident as ‘*any person who, under the laws of that State, is liable to tax therein (...)*’. Paragraph 8.6 and 8.7 of the OECD Commentary to Article 4 mentions that this requirement may sometimes result in uncertainties for pension funds, since these are often exempt from corporate income tax. We therefore welcome the OECD’s endorsement of the explicit recognition of pension funds as tax treaty residents and greatly appreciate that the draft Commentary to paragraph 8.6 now formalizes current practice by acknowledging that most states already view such entities as residents for purposes of the Model Tax Convention.

Pension funds can also be considered liable to tax irrespective of whether they benefit from an exemption from corporate income tax. To ensure the text of Article 4 of the Model Tax Convention is in line with paragraph 8.6 of the draft Commentary, we suggest slightly rephrasing paragraph 1 of article 4 of the Model Tax Convention (with addition in **bold underline** and deletion in ~~strike through~~) to avoid any doubt as to whether pension funds are considered liable to tax:

*“For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, **including recognized pension funds of that State** and also includes that State and any political subdivision or local authority thereof ~~as well as a recognised pension fund of that State.~~”*

Furthermore, it would be helpful if the text of the current paragraph 8.6 of the Commentary (which will be renumbered to paragraph 8.7) remains unchanged, so that it continues to mention a pension fund as an example of a person that is considered liable to comprehensive taxation even if a Contracting State does not in fact impose tax.

**2.2. As regards the term “retirement” as included in the definition of recognized pension fund in paragraph 1 of Article 3 of the Model Tax Convention**

The suggested definition of a recognised pension fund as is intended to be included in paragraph 1, subsection j) of Article 3 of the Model Tax Convention refers to an entity or arrangement that is constituted and operated to administer or provide “retirement or similar benefits” to individuals. In order to make this definition broadly applicable to the numerous types of pension funds worldwide and to take account of the particular interpretation that OECD Member States may have in relation to what is understood as a pension fund, we suggest adding the following to paragraph 1, subsection j) letter (i) of Article 3 of the Model Tax Convention (with addition in **bold underline**):

*“that is constituted and operated exclusively **or almost exclusively** to administer or provide **pension**, retirement or similar benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities;”*

By also including the term “pension”, it would be ensured that the definition is widely applicable, considering that not all OECD Member States may interpret the terms “pension” and “retirement” in the same way. By including both terms, the definition of a recognized pension fund would also be consistent with the definition of a pension fund as included in the 2016 US Model Income Tax Convention.

**2.3. As regards the phrase “and that is regulated as such by that State or one of its political subdivisions or local authorities”**

The proposed Article 3, paragraph 1, subparagraph j), subsection (i) sets out a secondary condition which must be met in order to qualify as a ‘recognised pension fund’ by requiring a pension fund to be “regulated as such by that State”. This phrase may not be sufficiently broad when considering government funds constituted to provide pensions, for the reason that such funds are government owned and governments do not tend to regulate themselves. Therefore, we consider that the Commentary should acknowledge that, in respect of government funds, the regulation itself can take any form as long as it is endorsed by that State. For example, a government fund would meet the “regulation test” if it can point to the existence of provisions for accountability and review contained in its constituting legislation.

With this in mind, together with the our comments made in the final paragraph of section 1.1 above regarding the fact that some government funds will not be administering or providing benefits to individuals directly, we recommend further amending Article 3, paragraph 1, subparagraph j), subsection (i) to remove the reference to “as such” so that it reads (deletion in ~~strike through~~):

*“(...) and that is regulated ~~as such~~ by that State or one of its political subdivisions or local authorities”*

We are of course willing to further contribute to matter brought forward by the OECD that are of interest to pension funds worldwide and would gladly provide you with further input.

Sincerely,

Jacquelyn Colville  
Chief Financial Officer  
Alberta Investment Management Corp.

Klaus Stürmer  
Managing Director  
Arbeitsgemeinschaft kommunale und kirchliche  
Altersversorgung Corporation (AKA)

[signed]

[signed]

Evert-Jan Spoelder  
Senior Tax Counsel  
APG Asset Management

Neil Marcovitz  
Vice President, Tax  
British Columbia Investment Management  
Corporation

[signed]

[signed]

Steve Bossé  
Vice President, Taxation  
Caisse de dépôt et placement du Québec

[signed]

John Payne  
Head of Tax  
New Zealand Superannuation Fund

[signed]

Doug Michael  
Chief Financial Officer  
OPTrust

[signed]

Maj-Britt Klemp  
Head of Tax  
PensionDanmark

[signed]

Jean-François Ratté  
Vice President, Taxation  
Public Sector Pension Investment Board

[signed]

Jonathan Gilmore  
Head of Tax  
Universities Superannuation Scheme (USS)

[signed]

Kristina Fanjoy  
Managing Director, Head of Tax  
Canada Pension Plan Investment Board

[signed]

Serena Lefort  
Head of Tax  
OMERS

[signed]

Hersh Joshi  
Vice President, Taxation  
Ontario Teachers' Pension Plan Board

[signed]

Niels Krook  
Head of Tax  
PGGM Investment Management

[signed]

Vince Quagliata  
Head of Tax  
QIC

[signed]