

MEMO# 5595

February 22, 1994

INSTITUTE COMMENTS ON MODEL INCOME TAX TREATY

1 See Institute Memorandum to Tax Members No. 52-90, Accounting/Treasurers Members No. 26- 90 and International Funds Task Force No. 29-90, dated November 30, 1990. 2 As you may know, over a year ago France suspended its payment of refund claims to pension funds, RICs and others while it reviewed the application of its reclaim process. February 22, 1994 TO: INTERNATIONAL COMMITTEE NO. 2-94 TAX COMMITTEE NO. 7-94 RE: INSTITUTE COMMENTS ON MODEL INCOME TAX TREATY

In recent years, both the United Kingdom and France have questioned whether some or all regulated investment companies ("RICs") are entitled to benefits generally provided to U.S. corporations pursuant to income tax treaties with the United States. In 1990, the Institute negotiated an understanding with the United Kingdom's Inland Revenue that resulted in RICs organized as Massachusetts Business Trusts receiving the same tax treaty benefits afforded to other U.S. corporations (including RICs organized in corporate form).¹ Currently, the Institute is urging France to process promptly those tax refund claims filed by RICs.² The Institute is also seeking to ensure that RICs receive appropriate treaty benefits by urging clarification of the specific treaty language that provides such benefits. As part of this effort, the Institute has prepared the attached comments on the United States Model Income Tax Treaty, which is currently being redrafted. The comments are presented in two parts, with the first addressing issues relating to a RIC's eligibility for treaty benefits and the second addressing application of tax treaties to master-feeder structures where the master fund is an entity, such as a U.S. partnership, that is not taxed in its country of residence. The Institute's memorandum makes three recommendations regarding the eligibility of RICs for treaty benefits. First, a RIC should be expressly classified as a corporation for all treaty purposes and should be treated as the beneficial owner of its income regardless of its form of organization under state law. Second, the "publicly-traded" exception in the model's limitation on benefits article should be expanded/clarified to include all RICs and not just those closed-end funds that trade on a "recognized stock exchange." Third, U.S. treaty negotiators should confirm that treaty procedures, including processing of refund claims and establishing eligibility for withholding and other reliefs, will be implemented by RICs at the entity level. With respect to master-feeder structures, the Institute urges clarification of treaty applicability where (1) a master fund is established as a partnership or other flow-through entity, (2) income from the source country is not taxed at the master fund level (i.e., the master fund is treated as "tax transparent" in its country of organization) and (3) the feeder fund's portion of the master fund's income is currently subject to tax in the feeder fund's country of residence (e.g., the United States, in the case of a RIC feeder). If these conditions are met, income paid to the master fund should be eligible for treaty benefits, under the treaty between the source country (i.e., the country in which the portfolio investment is made) and the country

in which the feeder fund is located, to the extent that the master fund's income is subject to tax in the hands of the feeder fund or its shareholders. We will keep you informed of developments. Keith D. Lawson Associate Counsel - Tax Attachment

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