



# ACTL Conference on REITs

Recent tax treaty developments and their implications for REITs

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Prof. Arnaud de Graaf  
degraaf@law.eur.nl

# 0.0- Introduction

1. REITs in cross-border context
2. Entitlement to treaty benefits for REITs
3. OECD/G20 BEPS Project, its impact on REITs
4. LOB and EU freedoms
5. Conclusion

# 1.0- REITs in cross-border context

- REIT X organised in State R owns real estate situated in State S
- What kind of income REIT X derives from its investment depends, for tax purposes, on how investment is structured
- Following three situations can be distinguished:
  1. Investment is held directly, as illustrated in slide 1.1
  2. Investment is held indirectly through a foreign subsidiary, as illustrated in slide 1.2
  3. Investment is held indirectly through a foreign REIT, as illustrated in slide 1.3

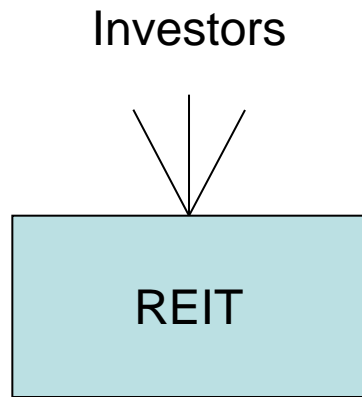


# 1.1- REITs in cross-border context



State R

State S



*rental income*

←

*capital gains*

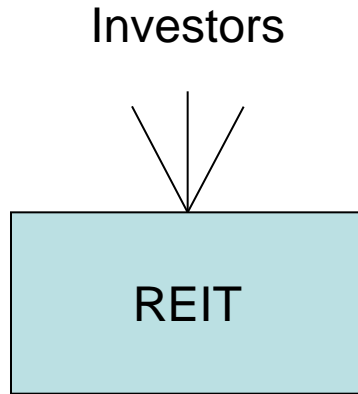
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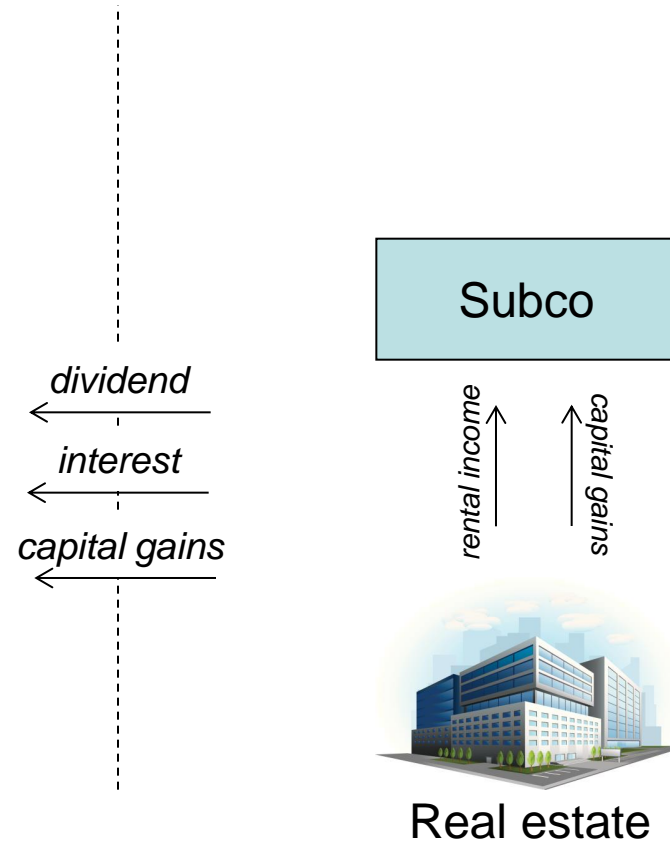
Real estate

# 1.2- REITs in cross-border context

State R

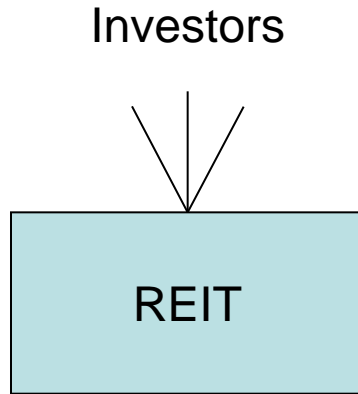


State S

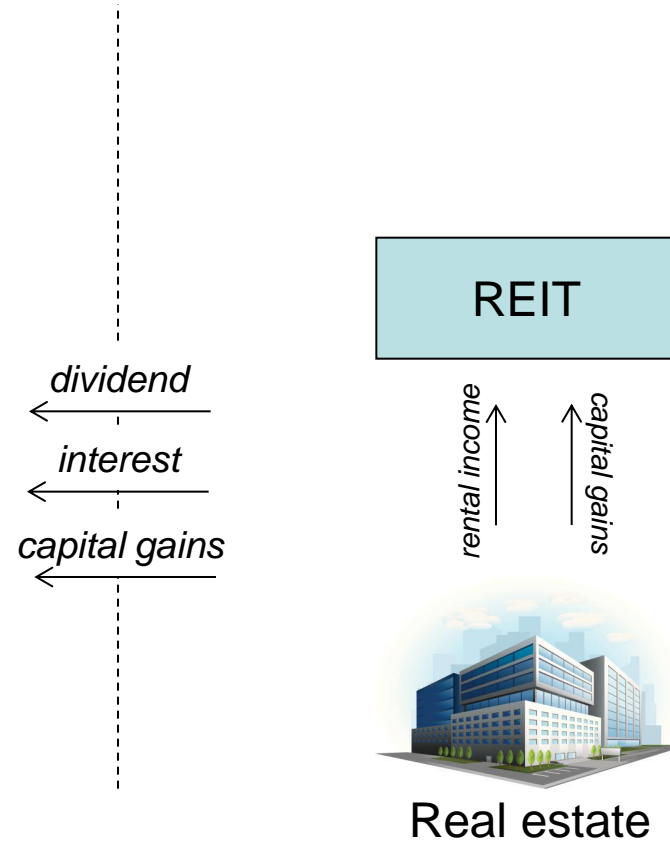


# 1.3- REITs in cross-border context

State R



State S



# 1.4- REITs in cross-border context

Taxing Right State S, OECD Model	Rental Income	Dividend	Interest	Capital Gain
Directly	Unlimited taxing right, Art. 6(1) OECD	N.A.	N.A.	Unlimited taxing right, Art. 13(1) OECD
Foreign Sub	Unlimited taxing right	5% WHT, Art. 10(2)(a) OECD	10% WHT, Art. 11(2) OECD	Unlimited taxing right, <u>if</u> Art. 13(4) OECD 2003
Foreign REIT	Unlimited taxing right	Unlimited taxing right, § 67.4 on art. 10 2008	10% WHT, Art. 11(2) OECD	Unlimited taxing right, <u>if</u> Art. 13(4) OECD 2003



# 1.5- REITs in cross-border context

- Text of Art. 13(4) OECD:

Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.

- Text of § 67.4 OMC on Art. 10 OECD:

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State (other than a beneficial owner of dividends paid by a company which is a REIT in which such person holds, directly or indirectly, capital that represents at 10 per cent of the value of all the capital in that company), the tax so charged shall not exceed: ...



# 1.5- REITs in cross-border context

Taxing Right State S, <u>US Model</u> <u>2006</u>	Rental Income	Dividend	Interest	Capital Gain
Directly	Similar to OECD Model	N.A.	N.A.	Similar to OECD Model
Foreign Sub	Unlimited taxing right	Similar to OECD Model	15% WHT, Art. 11(2) US	Similar to OECD Model, Art. 13(1 + 2) US
Foreign REIT	Unlimited taxing right	Similar to OECD Model, Art. 10(3) US	15% WHT, Art. 11(2) US	Similar to OECD Model, Art. 13(1 + 2) US



# 1.6- REITs in cross-border context

<b>Taxing Right State S, NL Treaty Policy</b>	<b>Rental Income</b>	<b>Dividend</b>	<b>Interest</b>	<b>Capital Gain</b>
Directly	Similar to OECD Model	N.A.	N.A.	Similar to OECD Model
Foreign Sub	Unlimited taxing right	No taxing right, Art.10(2)(a) NL Model	No taxing right, Art. 11(1) NL Model	No taxing right, Art. 13(4) NL Model
Foreign REIT	Unlimited taxing right	No taxing right, Art. 10(2)(a) NL Model	No taxing right, Art.11(1) NL Model	No taxing right, Art. 13(4) NL Model



# 1.7- REITs in cross-border context

- Main difference between OECD and US Model versus NL treaty practice is that source state under NL Model has no taxing right(s) if use is made of foreign entity
- Reservation NL § 51 Commentary on Art. 13(4) OECD (right not to include)
- However, NL accepted a provision similar to Art. 13(4) OECD in its treaties with:

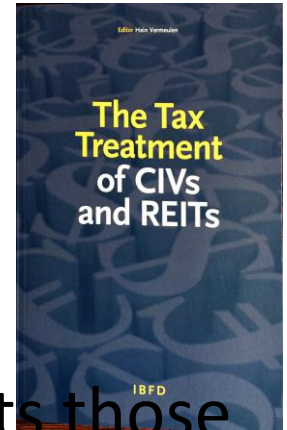
Singapore (1973), France (1973), Israel (1973), Australia (1976), Pakistan (1982), Canada (1986), India (1988), US (1992), Mexico (1993), Ukraine (1995), Vietnam (1995), Argentina (1996), Taiwan (2001), UK (2008), Switzerland (2010), Hong Kong (2010), Japan (2010), Germany (2012), China (2013)

- NL agreed provision similar to § 67 OMC on Art. 10 OECD only with US. Taxing right of source state is limited to 15% if REIT pays to *beleggingsinstelling* or vice versa, Art. 10(4)(c)(iv) US/NL



## 2.0- Entitlement to treaty benefits

- To have access to these treaty benefits (restrictions on source taxation), a REIT has to pass at least the following three tests:
  1. Person
  2. Resident
  3. Beneficial owner
- Whether a *fiscale beleggingsinstelling* meets those tests was discussed in my presentation 2 years ago and in my contribution to booklet *The Tax ...*
- However, there might be a fourth requirement, e.g. all US tax treaties contain LOB
- Only a few treaties entered into by NL contain LOB



# 2.1- Entitlement to treaty benefits



Treaty partner of NL	LOB, Article?	What benefits?	Can FBI qualify?
US (1992, 2004)	26 US/NL	All	Publicly-traded companies test (2)(c) Ownership test (2)(f) Derivative benefit test (3)
Japan (2010)	21 J/NL	All	Publicly-traded companies test (2)(c) Ownership test (2)(e) Derivative benefit test (3)
Hong Kong (2010)	10(3)(a-e) HK/NL	Participation dividends	...
Panama (2010)	10(3)(a-d) HK/NL	Participation dividends	...

## 2.2- Entitlement to treaty benefits

- CIVs and REITs may not be a qualified person under LOB rule, because, in many cases:
  - the interests in CIVs/REITs are not publicly-traded (even though these interests are widely distributed);
  - these interests are held by residents of 3<sup>rd</sup> states;
  - distributions made by CIVs/REITs are deductible payments



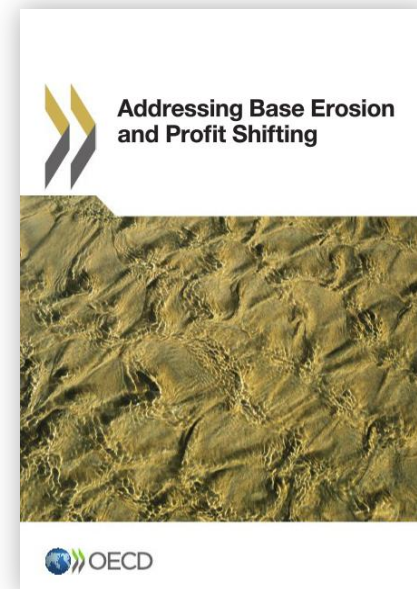
# 3.0- OECD/G20 BEPS project

- Financial and economic crises and austerity measures
- Increased media attention on whether multinationals pay sufficient tax on their profits
- Public perception that multinationals don't pay their fair share
- In response G20 leaders stated the need to prevent **base erosion and profit shifting” and that they would “follow with attention the ongoing work of the OECD in this area” (Mexico, 18-19 June 2012)**



# 3.1- OECD/G20 BEPS project

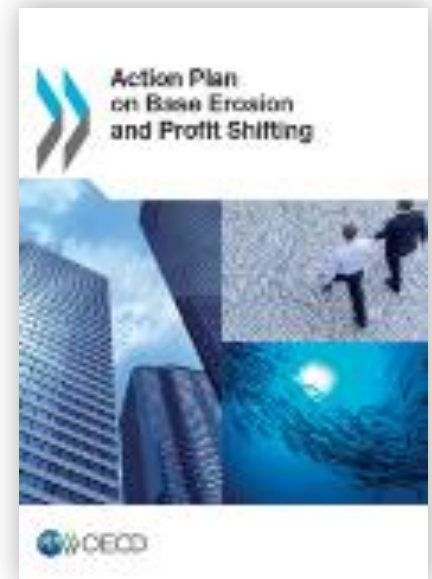
- Early 2013, OECD published its report 'Addressing Base Erosion and Profit Shifting'
- MNEs exploit differences in domestic tax systems to minimise tax burden
- BEPS strategies constitute serious risk to revenues, sovereignty and fairness
- OECD announced it would develop a comprehensive action plan to address the issue of BEPS in order to uphold the integrity of the CIT of states





## 3.2- OECD/G20 BEPS project

- In June 2013, OECD published its 2-year Action Plan on BEPS
- G20 endorsed OECD's Action Plan (Russia, Sept 2013)
- Action Plan identifies 15 actions to address BEPS
- Actions primarily built on 3 pillars:
  1. Coordination of the interaction of domestic CITs to enhance cross border coherence (no. 2 - 5)
  2. Fixing flaws in the international standards (no. 1 and 6 - 10)
  3. Improving tax transparency (no. 5, 11 and 12)



No.	Action	Expected output	Deadline
1	Address the tax challenges of the digital economy	Report identifying issues and possible actions to address them	<b>9/2014</b>
2	Neutralise effects of hybrid mismatch arrangements	Changes to OECD Model	<b>9/2014</b>
		Recommendations regarding the design of domestic rules	<b>9/2014</b>
3	Strengthen CFC-rules	Recommendations regarding the design of domestic rules	9/2015
4	Limit base erosion via interest deductions and other financial payments	Recommendations regarding the design of domestic rules	9/2015
		Changes to TP-guidelines	12/2015
5	Counter harmful tax practices more effectively	Finalise review of member country regimes	<b>9/2014</b>
		Strategy to expand participation to non-OECD members	9/2015
		Review of existing criteria	12/2015
6	Prevent treaty abuse	Changes to OECD Model	<b>9/2014</b>
		Recommendations regarding the design of domestic rules	<b>9/2014</b>
7	Prevent artificial avoidance of PE status	Changes to OECD Model	9/2015
8	Assure TP-outcomes are in line with value creation: intangibles	Changes to TP-guidelines and possibly to OECD Model	<b>9/2014</b>
			9/2015

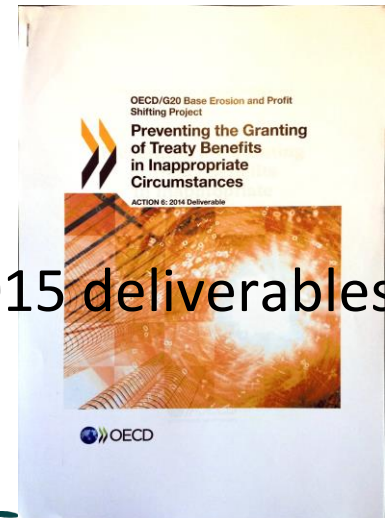
No.	Action	Expected output	Deadline
9	Assure TP-outcomes are in line with value creation: risks and capital	Changes to TP-guidelines and possibly to OECD Model	9/2015
10	Assure TP-outcomes are in line with value creation: other high-risk transactions	Changes to TP-guidelines and possibly to OECD Model	9/2015
11	Establish methodologies to collect and analyse data on BEPS and the actions to address it	Recommendations regarding data to be collected and methodologies to analyse them	9/2015
12	Require taxpayers to disclose their aggressive tax planning arrangements	Recommendations regarding the design of domestic rules	9/2015
13	Re-examine TP-documentation	Changes to TP-guidelines and recommendations regarding design of domestic rules	9/2014
14	Make dispute resolution mechanisms more effective	Changes to OECD Model	<b>9/2014</b>
15	Develop a multilateral instrument	Report identifying relevant public international law and tax issues	<b>9/2014</b>
		Develop a multilateral instrument	12/2015

## 3.3- OECD/G20 BEPS project

- In March 2014, the OECD released its discussion draft on BEPS Action item 6
- According to draft, states should incorporate into their treaties sufficient safeguards against treaty shopping. These must include LOB (art. X(1-5) OECD) as well as MPT (art. X(6) OECD)
- Furthermore, it is proposed to amend art. 13(4) OECD in order to address cases where assets are contributed to an entity shortly before the sale of its shares in order to dilute the value of these shares that is derived from immovable property
- On the draft, the REIT industry commented:  
CIVs, REIFs and REITs would be excluded from tax treaties if recommendations were to be implemented

# 3.4- OECD/G20 BEPS project

- In September 2014, the OECD published its seven 2014 deliverables, including its report: 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances (Action 6: 2014 Deliverable)'
- Report contains the following recommendations:
  - Inclusion as a minimum standard (§ 14): a. LOB + PPT (combined approach), b. LOB + mechanism against conduit arrangements, or c. PPT
  - Revision of art. 13(4)
- Reports are not yet final, because:
  - 2014 deliverables are closely connected to 2015 deliverables
  - Further work needs to be done



## 3.5- OECD/G20 BEPS project

- Recommended LOB rule has been redrafted. OECD acknowledges that LOB should not unduly impact CIVs and non-CIV funds
- A resident is a qualified person, if the resident is
  - a) an individual;  
§ 9 of Commentary on LOB rule: ... As explained in paragraph 35 below, under some treaty provisions, a CIV must be treated as an individual for the purposes of applying the relevant treaty; ...
  - f) [possible provision on collective investment vehicles]<sup>1</sup>  
[Footnote 1:] This subparagraph should be drafted (or omitted) base on how CIVs are treated in the Convention and are used and treated in each Contracting State: see the Commentary on the subparagraph and paragraphs 6.4 to 6.38 of the Commentary on Article 1.



## 3.6- OECD/G20 BEPS project

In its explanatory statement, the OECD remarked:

Action 6 provided for developing model tax treaty provisions that would ... grant treaty benefits only in appropriate circumstances. All countries have agreed that anti-treaty abuse provisions should be included in tax treaties. ...

A minimum standard has been agreed upon and this will ensure that treaty shopping and ... are no longer possible .... It is also recognised that the work on treaty abuse may impact existing business structures and may reveal a need for improvements of existing policies in order not to hamper investments, trade and economic growth. For example, policy considerations will be addressed to make sure that these rules do not unduly impact CIVs and non-CIVs funds in cases where countries do not intend to deprive them of treaty benefits. Finally, additional work is needed with respect to the contents of the model provisions and the relevant Commentary, in particular the limitation on benefits rule. Further work on these model treaty provisions and relevant Commentary and with respect to the policy considerations relevant to treaty entitlement of CIVs and non-CIVs funds will be finalised by September 2015.



# 4.0- LOB and EU freedoms

- § 6 of report states:

Some countries may have constitutional or EU law restrictions that prevent them from adopting the exact wording of the model provisions that are recommended in this report.

- Discussion in EU context: Does refusal of treaty access in event of:

- Sole listing in third state;

- Insufficient shares held in entity by treaty state residents; or

- Deductible payments to non-treaty state residents exceeding specific %

contravene EU freedoms?

- Judgments ruled by ECJ:

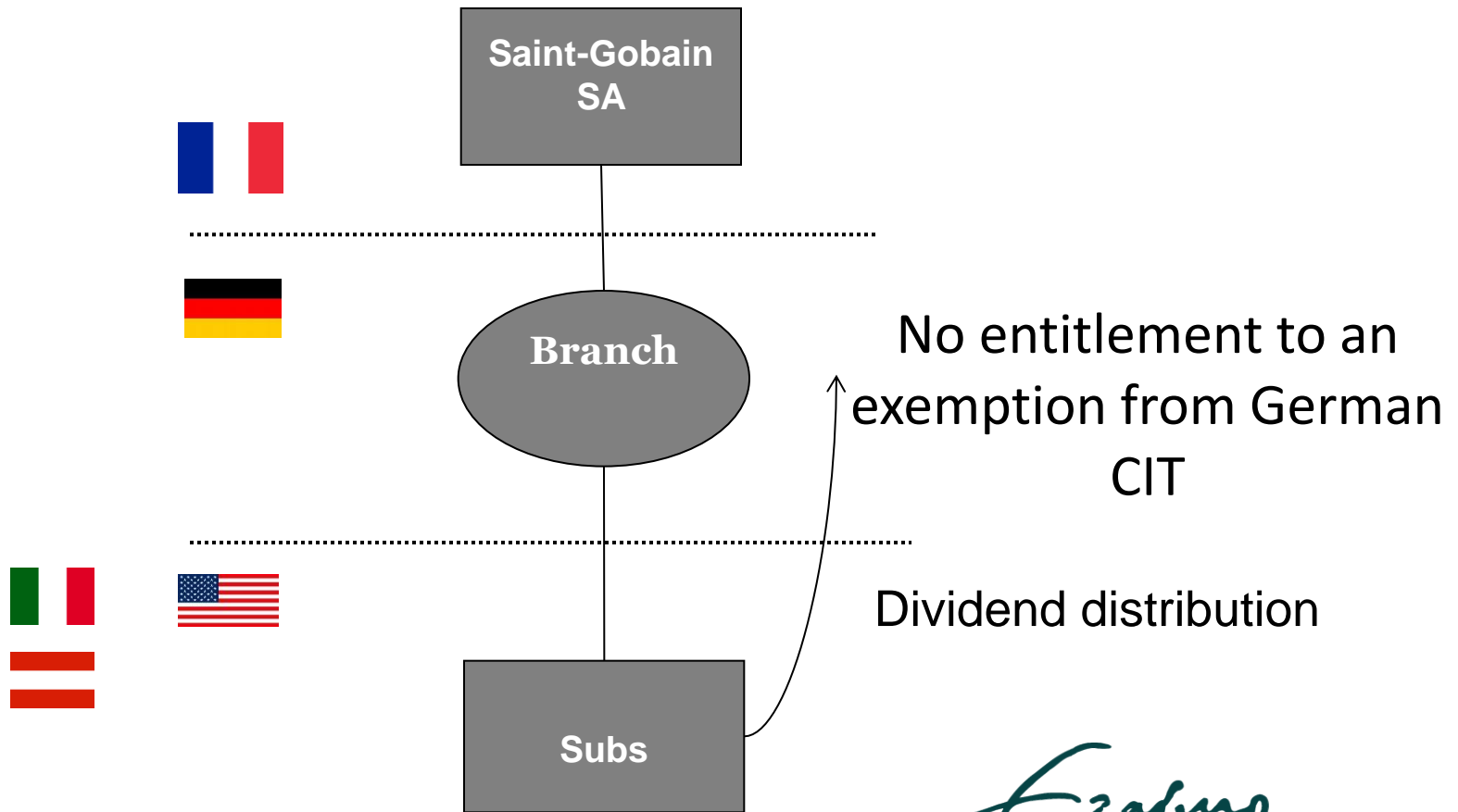
- Saint-Gobain case, C-307/97

- “Open Skies” cases (Nov. 2002)

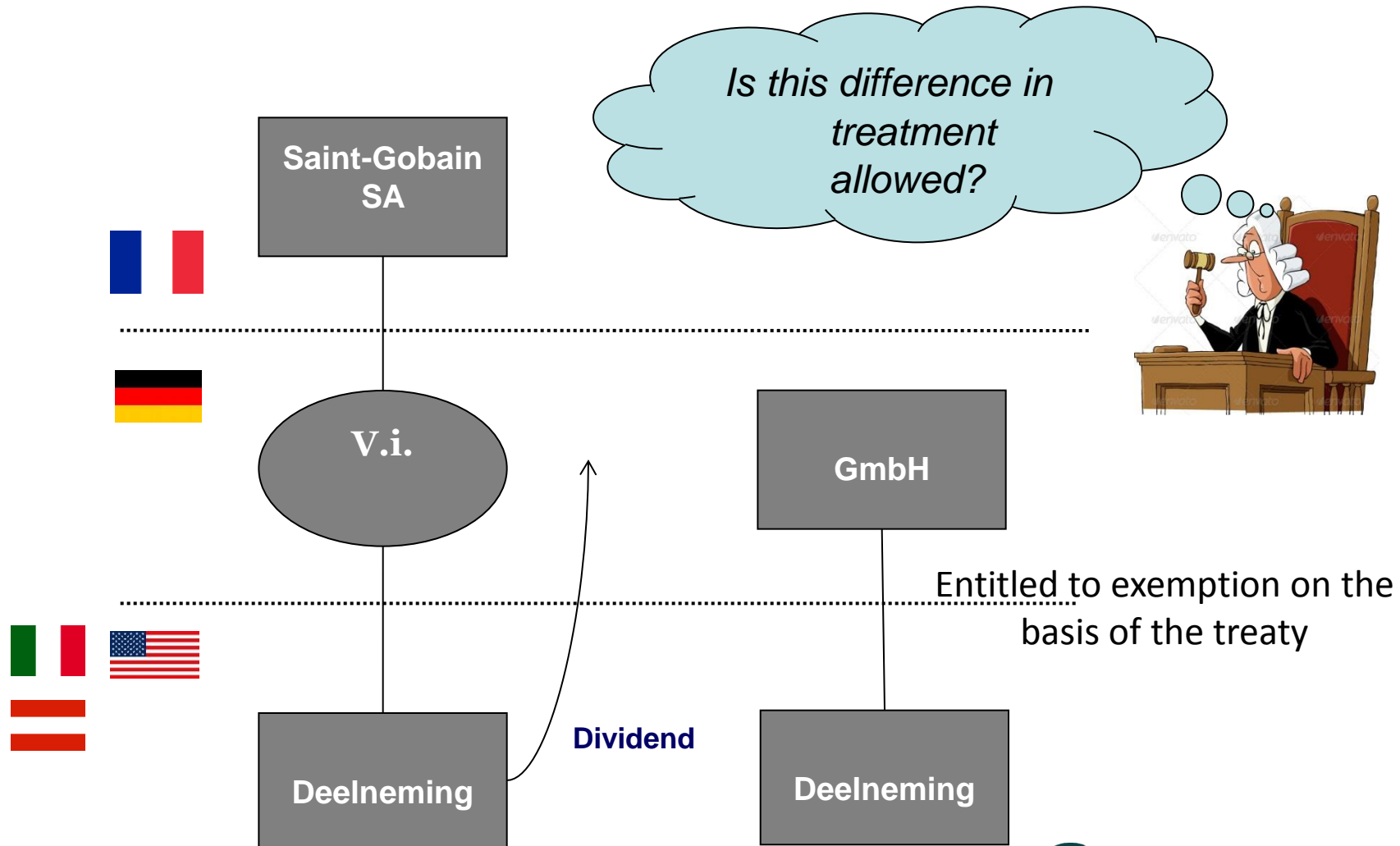




# Saint-Gobain, C-307/97 (Grant an exemption?)



# Saint-Gobain, C-307/97



# Open sky, C-466/98 (to grant treaty benefits: LOB)



Member State

Owner

Incl. Denmark,  
Germany, UK and NL

Airline  
company

Open sky  
agreement

Flights

No landing rights

US

# 5.0- Conclusion

- The OECD created a lot of confusion by releasing its draft discussion paper in March
- The OECD and its Member States have listened to the voice of the industry
- Whether the impact might be limited, still needs to be seen
- It depends on what the OECD is going to in the coming year and how countries are going to implement the recommendations

