

110 Bishopsgate  
19th Floor, Suites 19-06 and 19-07  
London EC2N 4AY, UK  
+44 (0) 207 961 0830  
www.iciglobal.org

Suite 715–717, Level 7  
Two Exchange Square  
8 Connaught Place  
Central, Hong Kong  
+852 2168 0882

1401 H Street, NW  
Suite 1200  
Washington, DC 20005, USA  
+001 202 326 5800  
www.ici.org

+001 202 326 5832  
MOBILE: +001 202 957 7226  
lawson@ici.org

*By Electronic Delivery*

31 December 2015

Director (Tax Policy & Legislation)-I  
Central Board of Direct Taxes,  
Room No. 147-D  
North Block,  
New Delhi – 110001  
India

RE: *CIVs, Their Managers, and the Place of  
Effective Management Draft Guidance*

Dear Director (Tax Policy & Legislation)-I:

ICI Global,<sup>1</sup> on behalf of our collective investment vehicle (CIV)<sup>2</sup> industry members, respectfully request that any final guidance issued by the CBDT regarding place of effective management (POEM)<sup>3</sup> confirm that non-Indian CIVs are not Indian tax residents. The consequences to a CIV of being tax resident in any country other than its country of organization are so detrimental that CIVs would have very serious reservations about investing in any country in which this possibility existed.

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<sup>1</sup> The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US\$19.4 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.

<sup>2</sup> A CIV is defined for this purpose consistently with the OECD's Report entitled "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" (the "CIV Report"), found at <http://www.oecd.org/tax/treaties/45359261.pdf>. Specifically, CIVs are defined as "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." CIV Report, page 3, paragraph 4. Funds that are not treated as CIVs in the CIV Report (and that are not addressed in our comments) include "investments through private equity funds, hedge funds or trust or other entities that do not fall within the [Report's] definition of CIV." *Id.*

<sup>3</sup> <http://www.incometaxindia.gov.in/Documents/POEM-note-for-uploading.pdf>. This draft guidance (F. No. 142/11/2015-TPL) was issued by the CBDT on 23 December 2015 with a 10-day comment period that includes two major holidays. Consequently, we respectfully request your understanding should we supplement this submission.

We also respectfully request confirmation for CIV managers of the conclusions reached by the Organisation for Economic Co-operation and Development (OECD) and the non-OECD G20 members (including India) in the final Base Erosion and Profit Shifting (BEPS) Action 7 Report.<sup>4</sup> Specifically, we respectfully request confirmation that investigating or researching companies in which its CIVs will invest, from a CIV manager's fixed place of business within India, is not the type of key management and commercial decision that can create a taxable presence for the CIV manager. Furthermore, we respectfully request confirmation that a fixed place of business is an essential element of the POEM standard. Without a fixed place of business, there is no location within India from which key management and commercial decisions can be made.

As with the case for CIVs themselves, a CIV manager would be quite hesitant to seek investments for the CIVs it manages if the consequence was being treated as an Indian tax resident. The OECD, in the BEPS Action 7 Final Report delivered to the G20, includes an example addressing our concern.<sup>5</sup>

## The Draft Guiding Principles

### *The Legislative Rationale for the POEM Standard*

The amendment made to Section 6(3) of the Income-tax Act, 1961 by the Finance Act 2015 adopted the POEM standard because the old law created “tax avoidance opportunities to artificially escape . . . residential status . . . by shifting insignificant or isolated events . . . outside India.”<sup>6</sup> This statement reflects the internationally-recognized view that tax jurisdiction assertions must reflect an appropriate balance between a business' tax responsibilities to a jurisdiction and the benefits that the business receives from its activities within that jurisdiction. This sound tax policy position prevents a business with limited activities within a jurisdiction (and little revenue from those activities) from incurring the substantial administrative and compliance costs associated with a taxable presence.

Our proposals, as discussed below, do not allow for CIVs or their managers to “artificially escape residential status;” instead, our proposals are consistent with internationally-applied norms.

### *POEM Standard for a Company Engaged in Active Business Outside India*

The draft guiding principles provide, at paragraph 7, that the place of effective management of an active business will be presumed to be outside India if the majority of meetings of the Board of directors of the company are held outside India. The draft guiding principles in the next paragraph (7.1), however, create a facts and circumstances test that may lead to substantial disputes not involving artificial constructs. Specifically, this paragraph provides that if the facts and circumstances

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<sup>4</sup> This OECD document is entitled “BEPS Action 7: Preventing the Artificial Avoidance of PE Status.” See [http://www.oecd-ilibrary.org/taxation/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report\\_9789264241220-en](http://www.oecd-ilibrary.org/taxation/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report_9789264241220-en).

<sup>5</sup> Paragraph 22.6 of the BEPS Action 7 Final Report provides that, even if an investment manager *has* a fixed place of business in a country, collecting information on possible investments will not create a taxable presence.

<sup>6</sup> F. No. 142/11/2015-TPL, page 1. <http://www.incometaxindia.gov.in/Documents/POEM-note-for-uploading.pdf>

“establish” that the Board of directors are “standing aside and not exercising their powers of management,” then it must be determined who is exercising these powers. If the person(s) exercising these powers is/are resident in India, then India is the place of effective management and the company is an Indian tax resident.

### *The POEM Standard for a Passive Business*

The drafting guidelines provide, in paragraph 8, a two-step process for applying the POEM standard to companies (such as passive businesses) other than those engaged in active business outside India. The first step is to identify the person(s) “who actually make the key management and commercial decision for conduct of the company’s business as a whole.” The second step is to determine where these decisions in fact are being made (rather than implemented). The drafting guidelines then provide “principles” to be applied in making these determinations. These principles seek to determine where the key decisions are being made by focusing first on the board of directors, then on an executive committee of the board, and finally on the company’s senior management. As with the standard for active business, this facts and circumstances test may lead to substantial disputes not involving artificial constructs.

### **Overview of the CIV Industry**

Our recommendations are informed by CIV industry experiences in the global marketplace and the resulting tax controversies. To appreciate our concerns with the drafting guidelines, it is instructive to consider the nature of a CIV and the services provided to a CIV by its manager.

### *The Nature of a CIV*

A CIV is a pooled investment vehicle widely used by individuals to cost-effectively access the securities markets. The important advantages provided by CIVs include professional management, asset diversification, liquidity, and robust governmental regulation and oversight.

All functions of the CIV, which does not have employees of its own, are performed by third parties. The asset manager that has created the CIV often will perform many of these services. A CIV’s officers typically will be employees of the asset manager. The typical CIV is overseen by a board of directors or trustees responsible for ensuring that the CIV is operated in accordance with its organizational documents, local law, and the best interests of its investors.

A CIV is separate and distinct from the asset manager that created it. The CIV and the asset manager have different owners, their assets are totally separate, and they bear no responsibility for each other’s liabilities (including tax liabilities).

A CIV’s investment mandate (*e.g.*, stocks or bonds; country-specific, regional, or global; etc.) is prescribed in its offering document. Most CIVs disavow any interest in exercising any control over a company in which they invest. The CIV’s portfolio management team decides which specific securities to buy and sell and initiates the securities trades.

Investors' interests in a CIV typically are acquired either directly from the CIV (with the purchase reflected directly on the CIV transfer agent's/recordkeeper's books) or through a third-party distributor. All CIV investor transactions take into account, directly or indirectly, the value of the CIV's assets; CIVs calculate each day the net asset value (NAV) of their interests, pursuant to prescribed rules, by valuing their assets and liabilities and dividing net assets by the number of outstanding interests. Because of this precise calculation requirement, certainty regarding a CIV's tax liabilities is essential.

### *CIV Tax Treatment*

The tax treatment provided to CIVs effectively recognizes that CIVs do not carry on business activities. Internationally-recognized norms apply to CIVs based on the CIV's country of organization and the countries in which the CIV invests.

Most countries provide some mechanism by which their own CIVs incur no entity-level tax; the mechanism for providing this relief is contingent on the CIV meeting precise requirements in its country of origin. In the United States, for example, CIVs must meet the requirements for "regulated investment company" status;<sup>7</sup> any CIV meeting the applicable requirements is allowed to deduct the dividends that it distributes to its investors and thus is taxed (at regular corporate tax rates) only on income that it retains. This tax treatment effectively provides CIV investors with tax treatment comparable to that provided to direct investors. Other countries have different approaches that lead to the same result: no home-country tax on the CIV itself.

The only tax borne by the typical CIV is any withholding or capital gains tax that may be imposed on its portfolio transactions when the CIV is a nonresident investor. This same withholding and capital gains tax treatment likewise applies to other nonresident investors; these investors, such as individuals purchasing securities directly, are not treated as tax residents simply because they make non-controlling investments in the shares of other countries' companies. As noted by the Shah Committee, countries with a minimum alternate tax do not apply this tax on foreign companies or persons unless the foreigner has a physical presence in the country.<sup>8</sup>

### *Management Companies and Other Service Providers to CIVs*

The typical CIV asset manager offers its customers a wide range of financial products and provides them with an array of valuable services. The products may include CIVs, other investment pools (*e.g.*, hedge funds) that are not widely-held, insurance, and banking services. The services provided, in addition to offering these products, may include distribution, investment education, investment advice, wealth management, and/or estate planning.

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<sup>7</sup> See 26 United States Code §§ 851 *et seq.*

<sup>8</sup> See <http://finmin.nic.in/reports/ReportonApplicabilityofMinimumAlternateTax%20onFIIsFPIs.pdf> (page 68 of the Shah Committee Report).

The services that an asset manager may provide to a CIV could include:

- portfolio selection (which may involve portfolio managers (PMs), analysts, and research assistants);
- asset acquisition and disposition (often through multiple securities dealers);
- assistance in arranging asset custody (typically through a global custodian and regional/local subcustodians);
- regulatory compliance;
- investor recordkeeping (through a “transfer agent”); and
- investor communications (including transaction confirmations and periodic account statements).

### **CIV Industry Concerns with the POEM Standard Draft Guidance**

#### *The Draft Guidance Is Too Vague; Unproductive Tax Liability Assertions Will Result*

Our primary concern is that this guidance is too vague to provide nonresident taxpayers with any certainty that they are not Indian tax residents. To address this concern, the guidance should reflect expressly the stated objective of addressing tax avoidance opportunities to artificially escape residential status. One element of this approach would be precise guidance regarding the types of situations for which an Indian place of effective management does or does not exist.

Absent more precise guidance, revenue assessors may go far beyond the legislature’s stated objective in adopting the POEM standard. The inevitable result will be tax controversies that require foreign companies to expend significant time and incur significant expense but yield little if any revenue for India.

Because the POEM standard was crafted to address concerns about artificial constructs, it is essential that it be applied in a manner that does not lead to expensive and ultimately unproductive assertions of tax liability. If an entity has such limited contact with a country that assertions of taxing jurisdiction, and the resulting compliance costs, would make it uneconomic to enter the country in the first instance, the POEM standard should not result in the company being treated as an Indian tax resident.

#### *Applying the Draft Guidance to CIVs*

We respectfully request that any final POEM guidance confirm that non-Indian CIVs are not Indian tax residents. CIVs are not “engaged” in business; they are merely investment pools making portfolio investments. Moreover, as CIVs do not have employees of their own, they have no fixed place of business. Indeed, it was for these reasons that the Shah Committee’s recommended that the Indian Minimum Alternate Tax was not applicable to nonresident CIVs.<sup>9</sup>

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<sup>9</sup> See <http://finmin.nic.in/reports/ReportonApplicabilityofMinimumAlternateTax%20onFIIsFPIs.pdf> (Chapter VI of the Shah Committee Report).

The CIV industry relies heavily on all countries in which CIVs invest following the accepted international norm that passive investing by nonresident CIVs does not create any tax liability beyond withholding and capital gains taxes. Most countries impose withholding taxes only on dividends paid by their resident companies to nonresident investors. Some countries also impose withholding taxes on certain interest payments to nonresident investors. A few, including India, also impose tax on certain capital gains realized by nonresident investors.

The only country in which a CIV incurs any possible tax, other than withholding and capital gains tax, is the country in which the CIV is organized. Even in this case, most countries provide mechanisms (such as a deduction for dividends paid) that allows a CIV to eliminate essentially all CIV-level taxes. This approach allows CIV investors to receive tax treatment comparable to that received by direct investors.

Importantly, no country attributes to a CIV the activities of its manager. A CIV and its manager are neither owned by the same people nor involved in the same activities. A CIV is owned exclusively by its investors; a CIV manager typically will not invest in a CIV it manages (other than possibly to invest “seed money” that is used to “start up” a CIV; this money then is withdrawn after the CIV attracts investors). Similarly, while a CIV manager is an operating business, a CIV is merely an investment pool; the securities held in a CIV’s portfolio are non-controlling interests that do not in any way constitute a “business.”

Our concern on this point relates to the different requirements that countries impose on CIVs seeking to benefit from CIV-specific tax regimes; these regimes are necessary, as noted above, so that CIV investors are taxed only once (at the CIV-investor level) on the CIV’s income and gains. If a CIV is treated as being an Indian tax resident simply because its CIV manager conducts activities in India, the CIV most likely would incur substantial, inappropriately-applied tax. This tax liability concern arises because any CIV not offered to investors in that market would not have been structured consciously to meet that country’s requirements for any CIV-specific tax rules.

To eliminate the industry’s concern, which could impact investment decisions, we respectfully request that any final POEM guidance confirm that non-Indian CIVs are not Indian tax residents.

#### *Applying the Draft Guidance to CIV Managers*

We respectfully request confirmation on two points for CIV managers. First, we respectfully request confirmation that investigating or researching companies in which its CIVs will invest is not the type of “key management and commercial decision” that can create a taxable presence for the CIV manager. Second, we respectfully request confirmation that a fixed place of business is an essential element of the POEM standard. Without a fixed place of business, there is no location within India from which key management and commercial decisions can be made. More specifically, a company cannot “artificially escape . . . residential status . . . by shifting insignificant or isolated events . . . outside India” unless it also has a fixed place of business in India.

The process of collecting information on possible investments, as discussed above, is precisely the type of “contact” with a country that is too insignificant to justify treating a foreign company as a tax

resident. The information collection activities of CIV asset managers provide an apt illustration of this point.

Fund managers routinely collect information regarding investment opportunities for CIVs that they manage. The collected information is transmitted back to the manager's investment office along with information collected from other countries and regions. This information then is analyzed closely, often by a team of investment professionals with diverse responsibilities, before a portfolio manager makes any decision to buy or sell securities.

This information collection activity typically will not involve a fixed place of business. Portfolio managers and/or analysts routinely visit operating companies and meet with senior officers and employees to understand better a company's business activities, growth opportunities, etc. Publicly-available financial information also will be collected (sometimes from the internet rather than a visit).

While information has some intrinsic value (otherwise, companies would not incur the costs of collecting it), information-collection activities bear little relationship to management company revenues. Without the detailed examination of the information and data collected, and the rigorous comparisons of different investment opportunities, CIV's investors would not benefit from any information collected.

Moreover, were a taxable presence inappropriately asserted because of this information-collection activity, any small amount of revenue more than likely would be offset by the expenses (including employee compensation) of collecting this information. The limited amount of potential tax revenue – and the substantial burden of complying with potentially a hundred or more different tax regimes (for a CIV manager investing globally) – help explain why information collection should not be considered the key management decision-making process.

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Please feel free to contact me (at [lawson@ici.org](mailto:lawson@ici.org) or 001-202-326-5832) at your convenience if you would like to discuss this issue further or if we can provide you with any additional information.

Sincerely,

*/s/ Keith Lawson*

Keith Lawson  
Deputy General Counsel – Tax Law