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Dear Ms de Ruiter

RE: OECD DISCUSSION DRAFT ON BEPS ACTION 7

The Investment Association[1] welcomes the opportunity to comment on the BEPS Action 7 consultation.

We recognise the need to update the treaty definition of permanent establishment (PE) both to reflect better how businesses operate today and to prevent the artificial avoidance of PE status. We also support the broader objectives of the BEPS Action Plan.

Of the various aspects of the PE definition that could give rise to BEPS concerns and which are covered in the discussion draft, those designed to address the artificial avoidance of PE status through commissionnaire arrangements and similar strategies are of most relevance to investment managers.

Artificial avoidance of PE status through commissionnaire arrangements and similar strategies

We agree with the underlying policy objective that where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise should be considered to have sufficient taxable nexus in that country unless the intermediary is performing these activities in the course of an independent business. Four alternative proposals have been suggested to achieve this.

[1] The Investment Association (formerly the Investment Management Association) represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of around $5.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

Options A, B, C and D all address the concern of artificial avoidance of PE status through commissionnaire arrangements and similar strategies, but also lower the PE threshold generally in a way that applies to many other business arrangements.

Options A and C both replace “conclude contracts” in Art.5(5) with “engages with specific persons in a way that results in the conclusion of contracts”. The wording is so broad that the threshold at which a PE is created is effectively unascertainable and, on our reading, could result in the creation of PEs unnecessarily. Minor activities of an intermediary could give rise to a PE but with no commensurate increase in tax payable in the local jurisdiction on the basis that the PE is bearing minimal risk and so is allocated limited profits. We believe this would lower the PE threshold too far and would result in an unnecessary increase to the administrative burden for businesses.

Options B and D both replace “conclude contracts” with “concludes contracts, or negotiates the material elements of contracts”. This results in a lowering of the threshold but not to the same extent as would be achieved by options A and C. However, it would still seem to address the concern of artificial avoidance of PE status through commissionnaire arrangements and similar strategies. Most importantly we believe that the threshold for businesses creating a PE by “negotiating material elements of contracts” is ascertainable and controllable.

We would suggest that ‘terms’ replaces ‘elements’ as being more normally used in the context of contracts.

The difference between options B and D is that option B covers contracts in the name of the enterprise etc whilst option D deals with contracts which, by virtue of the legal relationship between that person and the enterprise, are on the account and risk of the enterprise. Of the two, option B seems clearer to interpret, whilst achieving the policy objective.

Examples in investment management businesses

Investment managers frequently work in a cross-border environment. This is the case where either the investment manager manages the assets of funds or other clients that are resident in other jurisdictions, or because the funds it manages are distributed to investors in other jurisdictions. It is common, therefore, for investment managers to have either branches or subsidiaries in other jurisdictions (although it is not a critical feature of investment management businesses).

Funds typically outsource all services, ranging from custody, fund administration, fund distribution and sales, transfer agency, and investment management. In most cases, the fund manager will be responsible for arranging the outsourcing of all of these services, and sometimes these services are provided from overseas.

Where overseas activities of a fund manager are significant and, for example, result in the conclusion of contracts, then they constitute permanent establishment. However there are also likely to be interactions with specific persons that are relatively minor, such as meetings to discuss a service level agreement with a transfer agent in a particular jurisdiction, or a distributor simply pointing an investor towards the group’s funds and leaving the investor to invest directly on standard terms.

In between these, there might be a range of other activities that are likely to be caught by the new wording but with a level of uncertainty, such as agreement of side letters, negotiation of separate accounts or discretionary fund management arrangements.

The key concern is the ability to ascertain the threshold of when a PE is created, given the many varied types of interaction that occur on a daily basis in an investment management business. Businesses should be able to control which types of meetings/interactions give rise to a taxable presence in any jurisdiction. We believe option B is the option that provides greatest certainty to investment managers.

Strengthening the requirement of independence

All of options A to D strengthen the requirement of independence in Art.5(6) in that third parties will no longer be treated as independent agents where acting 'exclusively or almost exclusively on behalf of one enterprise or associated enterprises'.

This seems to go further than the stated policy objective that "where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise should be considered to have a sufficient taxable nexus in that country unless the intermediary is performing these activities in the course of an independent business".

The requirements of an enterprise or of associated enterprises may be such that a third party has little need of any other business, yet in this case the third party will no longer be treated as independent.

In fact, many small investment managers act only for a single fund. In practice such small investment managers will have a relationship with the investors in the single fund, which will be numerous, and may regard these investors as its 'real' clients on a day-to-day basis – even though the contractual and commercial relationship is with the fund alone. In the UK and other countries, domestic law provisions exist to ensure that an investment manager in these circumstances will not be treated as a dependent agent and a permanent establishment of the fund it manages. We agree with the analysis and comments put forward by the Alternative Investment Management Association (AIMA) in its response to this consultation paper.

Thank you again for the opportunity to comment on the discussion draft. We hope to continue to be able to contribute to the consultation and I am available at your convenience to discuss anything in this letter at jmorley-smith@investmentuk.org or on +44 (0)20 7831 0898.

Yours sincerely

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cc. Mike Williams HM Treasury