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OECD – BEPS - Public consultation on the Global Anti-Base Erosion (GloBE) Proposal under Pillar Two

2 December 2019

I. INTRODUCTION

EFAMA* is grateful for the opportunity to comment on the OECD Public Consultation on Secretariat Proposal for a Global Anti-Base Erosion (GloBE) Proposal under Pillar Two.†

The four components of the GloBE proposal are:

a. An 'income inclusion rule' to tax the income of a low-taxed branch or controlled company;
b. An 'undertaxed payments rule' to deny a deduction or impose source taxation for a payment to a related party if the payment was not subject to a minimum level of tax;
c. A 'switch-over rule' in tax treaties to allow jurisdictions to impose a credit method instead of an exemption method in respect of income from permanent establishments or immovable property not subject to a minimum level of tax; and
d. A 'subject to tax rule' which would apply source taxation to certain payments and adjust treaty benefits on certain income where that payment is not subject to a minimum rate of tax.

* The European Fund and Asset Management Association, EFAMA, is the voice of the European investment management industry, representing 28 member associations, 59 corporate members and 22 associate members. At end 2018, total net assets of European investment funds reached EUR 15.2 trillion. These assets were managed by almost 62,000 investment funds, of which more than 33,000 were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining funds composed of AIFs (Alternative Investment Funds). www.efama.org

† Please refer to EFAMA's comments from March 2019.

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Under this proposal, changes to domestic law and tax treaties may be introduced *"to provide jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation"* - as noted in Chapter I, paragraph 7 of the Programme of Work (PoW).

With regard to the proposal of the Secretariat, the concerns of the European investment management industry are set out below. First we will ask for a carve out rules for investment vehicles, secondly we will highlight other implementation concerns and ask for an impact analysis of the proposals.

Investment vehicle carve out

Investment returns from an investment vehicle are taxed at the investor level upon distribution to prevent a distortion in investing on a pooled basis compared to investing directly into the underlying asset. The majority of governments recognises this and investment vehicles are therefore generally exempt from taxation to ensure that they are tax neutral for investors. This is particularly important for payments of dividends, interest and capital gains.

Investment structures should therefore explicitly be carved out from the Pillar Two proposals. The definition of investment structures should extend beyond collective investment vehicles ("CIVs") to cover similar investment pooling vehicles ("non CIVs") and include not just the entity in which investors directly hold their interests, but also any subsidiaries, holding companies and special purpose vehicles ("SPVs") through which the fund holds its investments.

We invite you to keep in mind that investment funds are structured as tax neutral investment pooling vehicles as a matter of public policy. The role that investment funds have to play in providing investors with a diversified portfolio and global market access is crucial and not to be underestimated.

EFAMA trusts that members of the inclusive framework are aware of the growth in investments held through these investment structures (CIVs and non-CIVs) has been very substantial in recent years and is expected to continue. Most countries that are being called to reach consensus on the Pillar 2 proposals have already dealt with domestic and foreign tax issues in this respect and provide for neutrality between direct investments and investments through investment funds.

The GloBE proposal should not risk all the achievements reached at the level of the OECD when it was called to address several challenges on the tax treatment of investment structures. In particular, members of the inclusive framework should be aware of the work of the OECD Committee on Fiscal Affairs, regarding the granting of treaty benefits for CIVs and the subsequent work on the principal purposes test or "PPT" rule for non-CIVs:

- **CIVs** - On 23 April 2010 the Committee adopted the report on "*The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles*", where the importance of CIVs is explicitly recognized. There we can find a number of suggested solutions with a view to ensuring CIVs could access tax treaties with a view to avoiding double taxation. Following to the work of the Committee on these issues, on 22 July 2010, the OECD Council approved an update to the Model Tax Convention addressing those issues.
- **Non-CIVs** - Furthermore, EFAMA urges you to remember the BEPS Action 6 Final Report on "*Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*". As, this Report and the subsequent further work addressed the inadvertent effects of the MLI[‡] on non-CIVs – ended in an explicit recognition from the OECD that non-CIVs should not be penalised by the proposals.[§] [**]

As noted in paragraph of the public consultation documents rules: *"these rules would be implemented by way of changes to domestic law and tax treaties and would incorporate a co-ordination or ordering rule to **avoid the risk of double taxation** that might otherwise arise where more than one jurisdiction sought to apply these rules to the same structure or arrangement."*

EFAMA is commenting on the public consultation document to welcome this policy intention (to avoid the risk of double taxation) and to ask members of the inclusive framework to address its concerns and not to jeopardize all the work that has been done at the level of the OECD, as well as at a EU level, on the treatment of investment structures. We invite you to revisit the aforementioned reports to better understand how returns are taxed at the investor level (please refer to section 2.2 of the 2010 CIV Report).

EFAMA urges the Secretariat and the members of the inclusive framework to ensure that no unintended adverse taxation effects arise from the GloBE proposals for investments through investment vehicles compared to direct investments by individual investors (principle of tax neutrality). As far as possible, the overall final tax burden for direct or indirect investments should be the same, irrespective of the vehicle used. The absence of special tax rules governing investment vehicles could result in an investment vehicles being treated as a separate taxpayer and a risk of potential economic double taxation of income received by the fund. Such an outcome will have a direct impact on European consumers, resulting in automatic reductions of the return on their investments.

If there is an anti-avoidance concern then any targeted anti-avoidance rule needs to be very carefully defined in a way that prevents Governments from arbitrarily or unfairly denying relief by applying excessive thresholds or test.

[‡] Multilateral Convention to implement Tax Treaty related measures to prevent Base Erosion and Profit Shifting.

[§] Please refer to EFAMA's comments on several public discussions regarding the implementation of BEPS Action 6 - from 2014, 2015 and 2017.

[**] As mentioned in paragraph 14 of the Action 6 Final Report *"the OECD recognises the economic importance of these funds and the need to ensure that treaty benefits be granted where appropriate."*

EFAMA is thus of the opinion that, if the secretariat concludes that the creation of carve-out rules it is not the best way to address our industry's needs, as they "may be more resistant to abuse"[††], safe harbour rules and specific implementation rules should be designed for investment funds in the context of the global anti-base erosion proposal, and in such way that the EU freedoms are respected (especially the free movement of capital).

Other implementation concerns

As noted in Section 4.1(3) of the Programme of Work (PoW) as well as in paragraph 77 of the public consultation document ***"it is necessary to ensure that the rules to be designed are compatible with existing international obligations, including where appropriate the EU fundamental freedoms"*.**

Subject to further impact analysis, EFAMA believes that members of the Inclusive Framework (EU Member States in particular) should not underestimate the unintended consequences that can arise from the proposals that are being discussed under Pillar Two. The introduction of new rules, under the GloBE proposal, could potentially lead to further distortions of capital markets within the EU and this is a crucial point to consider when proposing initiatives including from a tax perspective.

The impacts of their implementation should thus be revisited by the high-level working groups that are setting the milestones for the integration of capital markets in the EU, under the Capital Markets Union (CMU) plan. The common efforts of all EU Member States to promote investment and to help European savers realise their long-term financial objectives can be at risk if caution is not taken in the drafting of special rules for investment funds.[‡‡]

We would like to leave some additional concerns that should be kept in mind ahead of an impact analysis of the GloBE proposals:

- **Impact on Pensions**: It is not clear what the OECD's/governments' position is in this debate with regard to the funding of pensions. Given that Pension Funds are a dominant investor in Funds generally there is potentially a very significant impact on pension funding if the proposals go ahead without any appropriate carve outs.

[††] Paragraph 80 of the public consultation document mentions that: *"carve-outs based on facts and circumstances can be targeted or tailored to the specific situations intended to be covered and may be more resistant to abuse".*

[‡‡] According to a note from the Presidency of the Council of the EU that was recently issued on 28 October 2019, the ECOFIN Council was invited to examine initial findings on EU Law compatibility of the OECD proposals, as well as to work on impact analysis of these measures.

- **Impact on Investment vehicles and on capital markets**: Investment vehicles are built on the principles of providing access to investment markets as well as the ability to reduce risk for an investor through appropriate diversification (this would not be achievable for individual investors where they are investing directly).
    - Without due consideration being given to the position of investment vehicles, the proposals have the ability to make investments through investment vehicles significantly less efficient from a tax perspective and lead investors to opt out of funds, which could have a very negative impact on investors through increased risk (through direct investment) as well as a detrimental impact on capital markets in general. It has the potential to give rise to the outcome that international investment is not for everyone and certainly not for the smaller investor.
    - We should advocate that appropriate measures are introduced, ideally to exclude investment vehicles from the measures (we have always maintained that it is crucial that investment vehicles are effectively operated in a tax neutral position), or that would introduce appropriate measures to at least allow an investor to obtain credit for increased non-refundable/non-creditable withholding taxes suffered by an investment vehicle before any move is made to include investment vehicle in the application of minimum tax rules.

- **Tax Transparent Funds**: Bearing in mind the abovementioned pension fund debate (and the need to assess the impact on pensions) care needs to be taken to ensure that the proposals do not have any negative impact on the recognition of tax transparent funds. It should be borne in mind that where the tax transparency is recognised in the jurisdictions of the investor, the fund and the investment, there is a means of ensuring effective taxation is being accounted for at the investor level. That being said, given the heavily intermediated nature of the funds industry, it is important to recognise that there would need to be a major change in international tax law as well as a significant investment in technology by both governments and the investment management industry to ensure that such transparency can cover all investors.

EFAMA understands that a consensus-based long-term solution for the challenges that are being addressed under Pillar 2 calls for a proper evaluation of the economic impact of these proposals, especially in the EU single market. It is also highly advisable that EU Member States analyse the impact of these proposals and its compatibility with the EU Law.

CONCLUSION: EFAMA strongly supports that investment vehicles should explicitly be carved out from the Pillar Two proposals and asks for an impact analysis of these proposals at a EU level.

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We are grateful in advance for your attention to the concerns expressed in this letter and we welcome the opportunity to discuss these with you.

Yours sincerely,

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