European Fund and Asset Management Association

For the attn. of:

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OECD

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OECD – BEPS

Public consultation on

THE TAX CHALLENGES OF THE DIGITALISATION OF THE ECONOMY

I. INTRODUCTION

EFAMA[1] is grateful for the opportunity to comment on the OECD Public Consultation on "the Tax Challenges of the Digitalisation of the Economy".

EFAMA fully supports the aim of the Public Consultation to define an approach to the taxation of the digital economy and would kindly ask the OECD to keep the special requirements of investment funds in mind, especially when drafting those rules to make sure that Collective Investment Vehicles will not be covered by them. New tax rules should not underestimate the special requirements of our Industry, namely:

- The economies of scale from investments held through investment funds give access to markets, appropriately diversified, in which investors would otherwise not be able to invest. In case investors had to invest directly, they would incur substantial time and costs, not to mention the lack of market

[1] EFAMA is the voice of the European investment management industry. It represents through its 28 member associations and 62 corporate members more than EUR 16 trillion of investment fund assets at end Q3 2018. These assets were managed by almost 61,600 investment funds, of which close to 33,000 were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining funds composed of AIFs (Alternative Investment Funds). Including discretionary mandates, third-party regulated asset managers managed EUR 25 trillion in Europe at end 2017.

diversification. In the current investment climate it is imperative that investors are able to diversify risks across investments and international markets. Many territories encourage this type of activity and we therefore ask that explicit confirmation is provided that investment fund structures are not intended to be within the scope of the rules.

- The investment fund industry is a highly regulated industry by rules mainly set by important EU Directives (such as Directive 2009/65/EC for UCITS, and Directive 2011/61/EU for AIFMs and Directive 2014/65/EU on investment firms or on service providers distributing financial products) and that are reflected in the contractual arrangements entered into between various entities and intermediaries.
- From a tax perspective, except for investment funds whose tax treatment is designed to preserve their tax neutrality, it is however to be borne in mind that taxation arises at all levels in an investment fund structure namely, through withholding taxes applied at source, at investors' level and at the level of management companies, investment managers, distributors, etc... in line with the obligations set by the above mentioned regulatory framework.

In addition, it is very important that any new tax legislation on digital activities is not borne by the end-investors. Any new rules should be defined very carefully so that any new tax will not be a tax on European consumers. Certain tax burdens (e.g. transaction taxes) have to be treated as costs (in line with applicable accounting rules) that will directly and mechanically reduce the return on investment for investors.

The views and high-level concerns of the European investment management industry are set out below.

II. REPLY TO THE QUESTIONNAIRE

II.I. Revised profit allocation and nexus rules.

1. What is your general view on this proposal? In answering this question please consider the objectives, policy rationales, and economic and behavioural implications of the proposal. *(page 23 – Q1 of OECD public document).*

With respect to the first part of the consultation (revised profit allocation and nexus rules). EFAMA understands that the reform should be based on international consensus and agreement. EFAMA has concerns that, beyond the user participation proposal, it is not clear that OECD members have agreed on the problem they are trying to solve. It is therefore difficult to critique the different options covered by the public consultation document. Is the OECD addressing taxing rights more generally or is it addressing specific issues that relate to certain types of digital businesses or is it simply trying to ensure minimum taxation globally on all revenues. The answer to this question determines the approach to be taken.

EFAMA would like to point out that unilateral measures will increase the risk of double taxation. Binding arbitration rules in the event of disagreement between tax authorities should be a requirement of any new regime.

3. "What would be the most important design considerations in developing new profit allocation and nexus rules consistent with the proposals described above, including with respect to scope, thresholds, the treatment of losses, and the factors to be used in connection with profit allocation methods?" *(page 23 – Q3 of OECD public document).*

This question refers specifically for the first part (revised profit allocation and nexus rules). In that respect, the rules are potentially broad in scope and without care being taken in definitions, they will potentially affect businesses whose business models do not benefit from the issues that this proposals seeks to challenge. In the case of the user participation proposal, care will have to be taken in defining those business models that are in scope with a view to avoiding boundary issues. Similarly, in the case of the marketing intangibles proposal, the proposal should be focussed on 'highly digitalised businesses' and this term should be carefully defined to exclude from scope businesses who are not the intended targets of these proposals. Similarly care taken in the definition of consumer product business (Business to Consumer, or BtoC) - this term is extremely nebulous. Where a business model is not highly digitalised, Limited Risk Distributor (LRD), BtoC and/or service orientated, then these models should be clearly carved out in order to give businesses and tax authorities maximum certainty. Care should be taken in the determination of non-routine profits for the purposes of the marketing intangibles approach and the interaction with existing rules/the arm's length standard. This should only apply where one of the risk patterns identified above applies. The question of how taxing rights should be allocated, demands commitment to no double taxation. Rules should be designed to cater for losses as well as profits.

As mentioned above, aside from investment funds, the various players, such as management companies, investment advisers, depositaries, distributors, etc. involved in the industry are generally subject to ordinary taxation. We note that the investment fund and asset management industry being a highly regulated industry, those players are included in a strong regulatory framework built with the view to organize the market, inform and protect investors and ensure transparency. This framework is supported by contractual arrangements that reflect the regulatory obligations of those companies. With regards to the proposed revised profit allocation and nexus rules, we would recommend to ensure as far as possible that the tax and the regulatory frameworks remain consistent in order to avoid any distortion between them and ensure that no "deemed" service flows, that would not be reflected in existing regulatory or contractual arrangements, are artificially created.

II.II. Global anti-base erosion rules

1. What is your general view on this proposal? In answering this question please consider the objectives, policy rationales, and economic and behavioural implications of the proposal. *(page 29 – Q1 of OECD public document).*

With respect to the second part of the consultation (global anti-base erosion rules), special rules are essential for investment funds that benefit from low tax/zero tax regimes as a matter of public policy. This is particularly important for payments of dividends, interest and capital gains. Treaty benefits should not be denied to investment funds and the definition of investments funds should be extended beyond regulated investment funds to cover alternatives. ´

While we support the initiatives of the BEPS project we consider these proposals to be far-reaching and potentially damaging to genuine commercial activity in the investment management industry. There are many factors other than tax which drive the location of commercial activities and these commercial factors need to be considered when creating rules. Penalising genuine commercial activities will add cost to investors and potentially create a significant overhaul of investment fund structures and market access.

The proposed approach appears to be far reaching and goes beyond targeting intra-group financing structures or other planning structures that strip profit from high to low tax entities within the same group. We welcome the intention that these rules are not intended to affect the structuring and the location of decisions made for economic or business reasons. However we request that the final legislation includes well-structured motive based tests or substance rules which are not complex and arduous to apply so that genuine commercial activities or payments are not subject to these rules. Specific guidance is requested which appreciates the role that investment funds have to play in providing investors with a diversified portfolio and global market access without incurring unfavourable additional costs which would limit investment return.

3. What, if any, scope limitations should be considered in connection with the proposal set out above?

(page 29 – Q3 of OECD public document).

With respect to the second part of the consultation (global anti-base erosion rules), recognition needs to be given to the very specific business models that arise in the area of financial services. This was acknowledged in the OECDs interim report on digital (para 443, page 186). The heavily regulated nature of these businesses means that many of their business models are not a target of the proposals. Any special treatment for financial services needs to be universal rather than countries electing to exclude – such an outcome would almost certainly result in inconsistent application of the rules, double taxation/disputes.

We are concerned that any payment made by an investment fund to its investors or any income payment received on an investment by a fund may be considered, under the global anti-base erosion proposal, as undertaxed because it would be subject to a low (effective) tax rate at the level of the fund. This will create a clear challenge to the tax neutrality principle and a risk of potential economic double taxation of income received by the fund.

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.

The tax features of investment funds are designed to preserve the tax neutrality of investments made through investment funds compared to a direct investment and this principle has been recognized by the OECD and by the European Commission. EFAMA is thus of the opinion that safe harbour rules and specific implementation rules should be designed for investment funds in the context of the global anti-base erosion proposal. Failing that, investment funds would be placed in jeopardy and the whole investment fund industry could be damaged.

Special rules that only apply to large Multinational Enterprises (MNEs) as opposed to Small and Medium-sized Enterprises (SMEs) carry significant risk of complexity/double taxation/disputes, particularly for those businesses that are on the margin (and which may dip in/out of the new regime). The new rules should apply to all businesses whatever their size. Running different regimes for businesses of different size is likely to be more cumbersome/complex/expensive in the long run as taxpayers and tax authorities will have to apply different rules to ostensibly very similar businesses (the local operations of a small MNE and a large SME may look very similar).

4. How would you suggest that the rules should best be co-ordinated? *(page 29 – Q4 of OECD public document).*

The proposals **with respect to the second part of the consultation (global anti-base erosion rules)**, call for a clear timetable for implementation. For the sake of consistency and to avoid additional confusion rules should be implemented at the same time, with the same start date in all jurisdictions. The use of multilateral framework to ensure consistency of approach is advisable. Binding arbitration in the event of disputes should be a requirement of any new regime. Rules should only be implemented after extensive consultation with business to ensure that any new framework is robust and fair.

5. What could be the best approaches to reduce complexity, ensure early tax certainty and to avoid or resolve multi-jurisdictional disputes? *(page 29 – Q5 of OECD public document)*.

Please refer to our comments to question 4.

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Brussels, 6 March 2019

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