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OECD/G20 Inclusive Framework on BEPS

Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy: Global Anti-Base Erosion Proposal ("GloBE") - Pillar Two

The Alternative Investment Management Association (AIMA)¹ and the Alternative Credit Council (ACC)² would like to provide comments on the proposals set out in the OECD Secretariat's public consultation document relating to Pillar Two (GloBE proposal) as set out in the Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy (Programme of Work).

AIMA and the ACC consider that:

- the GloBE proposal cannot be effective unless adopted internationally on a consistent basis;
- it will affect many more businesses than are intended to be targeted by it;

¹ AIMA is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than \$2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 100 members that manage \$350 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

² The ACC currently represents over 170 members that manage over \$400bn of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy, providing finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well as the trade and receivables business. The ACC's core objectives are to provide direction on policy and regulatory matters, support wider advocacy and educational efforts, and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits.

- it will increase the compliance burden for taxpayers and tax authorities;
- it will require significant international dispute resolution mechanisms to be introduced; and
- an exemption is necessary for entities to which tax neutrality is a component attribute, such as investment funds and institutional investors.

We conclude that the GloBE proposal should not be pursued and that simpler solutions should be considered.

The GloBE proposal requires the development of rules to address structures that enable multinational enterprises (MNEs) to move profits to jurisdictions where there is no or very low taxation. These rules would (if adopted by the residence jurisdictions in particular) counter the ability of MNEs to avoid tax on profits which are not subject to taxation in market jurisdictions. Such rules can be regarded as a necessary accompaniment to the Pillar One rules. However, it would have to be ensured that the necessary changes to domestic law and tax treaties would be agreed and implemented uniformly if the GloBE proposal is to be effective.

AIMA and the ACC are concerned that, as the focus of the OECD's BEPS Action 1 work has moved away from MNEs operating in what might be regarded as tech or digital industries and now addresses the operation of the international tax system more broadly, the GloBE proposal, as also with Pillar One, will have consequences not only for very many businesses which operate in all sectors of the global economy including financial services and which would not be regarded as MNEs as the term is generally understood but also for entities such as investment funds and institutional investors whose income (quite properly) is not subject to taxation. Given the impact of BEPS, particularly the transfer pricing measures, and tax reform in the US (through the Tax Cuts and Jobs Act of 2017) and elsewhere on MNE corporate tax planning, we suggest that simpler mechanisms (such as controlled foreign company regimes) would address concerns more effectively.

The elements of the GloBE proposal (the four rules) are:

- an income inclusion rule applying to foreign branches and controlled entities;
- an undertaxed payments rule applying to payments to related parties;
- a switch-over rule permitting a jurisdiction to apply a credit method in place of exemption for double taxation relief; and
- a subject to tax rule applying to payments to related or unrelated parties.

The four rules are used to some extent by many jurisdictions, but it is unclear whether jurisdictions would be expected to adopt all four rules or be permitted to employ some combination of them. The relationship between the "subject to tax" rule and the "undertaxed payments" rule which it is said to complement, is not explained. We see practical difficulties in applying the "subject to tax" rule in transactions with unrelated parties. The switch-over rule will perpetuate the complexity of current foreign tax credit regimes.

The combination of the income inclusion rule and the undertaxed payments rule effectively imposes a global minimum tax. This is a major shift in international taxation standards since it moves from a territorial basis of taxation towards an inclusion system. The GloBE proposal therefore becomes both a minimum standard for taxation and anti-abuse, but also a maximum standard which raises further issues that are not addressed in the public consultation document.

As with Pillar One, there will be disagreements between MNEs and (multiple) jurisdictions on the operation of the four rules and the incidence of resulting tax liabilities. Truly effective dispute resolution mechanisms will be required. We draw to your attention the various submissions made in the Pillar One public consultation

concerning administrative proceedings and dispute resolution issues which are relevant also to the consideration of Pillar Two³. An expanded network of dispute resolution mechanisms will be required which will have to accommodate multilateral resolution.

The public consultation document requests comments specifically on three technical design aspects of the GloBE proposal:

- the use of financial accounts for determining the tax base and the need to address the effects of timing differences;
- blending of tax rates on income streams; and
- carve-outs and thresholds that may be appropriate.

An effective treatment of the first two design aspects is essential to the operation of the four rules. However, we wish to address the need for an exemption from Pillar Two for entities to which tax neutrality is a component attribute, such as investment funds and institutional investors:

- Very many jurisdictions recognise that savings and, in particular, pension provision are socially desirable, and that collective investment should be encouraged as a means of spreading risk while increasing opportunity and reducing costs while gaining the benefits of managerial expertise. Domestic investment and pension arrangements receive favourable tax treatment, usually through a tax exemption while offshore arrangements receive equivalent treatment subject to anti-avoidance rules (offshore funds regimes). If the four rules applied to such entities (or to transactions with such entities), the domestic tax treatment would be undermined. It would discourage cross-border capital raising and investment structures;
- The exemption should extend to all forms of investment funds and underlying fund structures. It could not be limited to (for example) UCITS and equivalent funds. As collective investment schemes, funds operate on the basis that there should be little or no taxation incurred by the fund so that investors are as nearly as possible in the same position in respect of the fund's investments as they would be if they held the investments themselves (since investors remain subject to tax in respect of their interests in the fund). By reason of such tax neutrality, there is no tax liability which should be considered appropriate for the fund to bear;
- The same argument extends to other structured financial products such as securitisation vehicles and to institutional investors such as pension schemes;
- The exemption would therefore be broad and would have to be adopted uniformly by all jurisdictions;
- Jurisdictions have the option of enacting rules for the taxation of investors in domestic and offshore funds to ensure equality of treatment. These rules are facilitated by tax transparency through measures such as the Common Reporting Standard; and
- The exemption would relieve the financial services industry and tax authorities of the significant compliance burden which would otherwise exist not only in determining the annual liabilities to tax of the fund or other entity but as a daily operational matter in computing the net asset value of the fund or establishing the status of the fund in relation to transactions with market counterparties.

³ In particular, we approve the Pillar One submissions made by the ICC and Slaughter and May.



We would be pleased to provide any further explanation required.

Yours sincerely

A handwritten signature in black ink, appearing to read 'PH', followed by a small horizontal line.

Paul Hale

Managing Director, Global Head of Tax Affairs
AIMA