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Submitted via email to taxpublicconsultation@oecd.org

Organisation for Economic Cooperation and Development
International Co-operation and Tax Administration Division OECD/CTPA.

Re: Investment Management Industry Response to the Inclusive Framework's Implementation Framework Consultation on the OECD Pillar Two Rules

Joint submission by
The Investment Association (the IA)
and
The Securities Industry and Financial Markets Association Asset Management Group (SIFMA AMG)
In Response to the Implementation Framework Consultation

Thank you for the opportunity to respond to the 14 March request by the Inclusive Framework for public comment on the Implementation Framework for the Global Anti-Base Erosion (GloBE) rules under Pillar Two. In this submission, we address the need for additional guidance now that the Pillar Two Model Rules and the Commentary on the Model Rules have been released in order to facilitate clarity and uniform application of the GloBE rules – the Income Inclusion Rule (IIR), the UTPR (formerly identified as the Undertaxed Payments Rule (UTPR)) and the Qualified Domestic Minimum Top-Up Tax (QDMTT). This is critical in ensuring that the rules address issues faced by asset managers while protecting the tax neutrality of investment funds to the greatest extent possible.

This response has been prepared the **Investment Association** (the IA)[1] and the **Securities Industry and Financial Markets Association Asset Management Group** (SIFMA AMG).[2] Our response is primarily

[1] The IA champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 270 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage over £9.4 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 44% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally. For more information, visit https://www.theia.org.

[2] The Securities Industry and Financial Markets Association's Asset Management Group ("SIFMA AMG" or "AMG") brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.

focussed on the treatment of investment entities under the GloBE rules and areas where further guidance can address issues and instances of double taxation, in keeping with the objectives of Pillar Two. Our response highlights areas where the OECD's Pillar Two Model Rules ('the Model Rules) do not adequately deal with the tax neutrality of fund structures or where double taxation of investments in funds could arise due to the difference between local country domestic rules and the GloBE rules.

I. Implementation Timing

As noted in the OECD's request for public input, the Implementation Framework is intended to facilitate the coordinated implementation and administration of the GloBE rules. In order to achieve this objective, the Inclusive Framework should revisit and align the application dates of the GloBE rules to the reality that most countries will likely delay legislation and implementation for at least another year beyond the deadlines agreed to last October.

The complexity of the Pillar Two rules, combined with the late release of the OECD Commentary ('the Commentary') explaining these rules, and the ongoing OECD consultation on important aspects of the Implementation Framework, necessitates that taxpayers and tax authorities have sufficient time to understand how the rules are intended to work, while the Inclusive Framework also needs to ensure consistency of adoption across jurisdictions. We are concerned that a rushed implementation by some countries but not others will result in unnecessary, significant, and disproportionate compliance costs for businesses while causing undue administrative burden on tax authorities. If introduced in 2023, there is a significant risk that there will be material issues with reports and tax payments due to the unreasonable timetable for implementation. More fundamentally, it is critical that there is common implementation and coordination of the rules globally, with explicit alignment between the GloBE rules and QDMTT regimes, to minimise the compliance burden, as well as functioning exchange of information regimes from day one to minimise duplicative reporting and effective use of safe harbours to eliminate low or zero risk entities/jurisdictions from the regime.

II. Request for Additional Guidance

We believe without further guidance, the Model Rules themselves, combined with the Commentary, contain gaps in application that raise several unanswered questions. In addition, we observe that the Model Rules and Commentary, without further guidance, could not only jeopardize the tax neutrality of investment funds but lead to double taxation. Therefore, it is critical that in this phase of its work on Pillar Two, the OECD consult with stakeholders in order to produce the guidance necessary to prevent a divergent application of the Model Rules among jurisdictions. As an overall interpretative matter, it will be important to confirm the precedential value of guidance issued so that the Commentary, guidance arising from the Implementation consultation, or subsequent rulings and interpretations are weighted equally in interpreting the correct application of the Model Rules.

The issues upon which we believe additional guidance is necessary at this point are below. We note, however, the timelines imposed to respond to these requests are short and as the Commentary is further analysed, additional issues are likely to arise.

III. Investment Entities

- *Transparency Election and Mark-to-Market (MTM) Requirement:* The election can only be made where an entity applies MTM accounting for its holding in an Investment Entity. This is problematic in countries where the parent is headquartered in jurisdictions in which interests in funds are required to be taxed on a realisation basis. This is because without the election, the Model Rules require the Effective Tax Rate (ETR) of the Investment Entity be calculated separately from the ETR of its parent entity. Taxes arising on any profit arising from the disposal of the Investment Entity will not be Covered Taxes for the ETR of the Investment Entity. As the Investment Entity will benefit from tax exemption on its profits (in line with intended policy in almost all OECD jurisdictions), the proposed mechanic creates an automatic top-up tax on the Investment Entity profits. Given there is no credit for Covered Taxes at the parent level, this results in double taxation.

The double tax that can result from the Filing Constituent Entity not being able to make the Transparency election could be addressed by clarifying that Covered Taxes (both current and deferred) arising at the parent level can be incorporated into the ETR of the investment Entity. While this scenario is not addressed directly by Article 4.3, it is consistent with the policy intention to align Covered Taxes with the underlying profits that they relate to.

- *Transparency Election and Covered Taxes:* If an MNE makes the transparency election under Article 7.5 of the Model Rules, a question arises as to whether the CE-owner can include the taxes charged on its MTM profit on the Investment Entity as Covered Taxes. The scheme and purpose of Article 7.5 is to align income and tax into the CE-owner and that should include taxes arising from MTM regimes. This should be the case, but it is not explicit. Therefore, guidance should explicitly clarify that taxes charged on MTM profits are Covered Taxes where an MNE makes a transparency election under Article 7.5 of the Model Rules.

- *GloBE Income Calculations for Investment Entities and Portfolio Shareholdings:* MNEs may consolidate numerous investment entities that follow a wide range of strategies. Some of these are taxed on a MTM basis, in which case the MNE can elect for transparency under Article 7.5 of the Model Rules. If not taxed on an MTM basis, the rules require calculation of the Investment Entities' ETR separately from the ETR of the MNE in the jurisdiction in which the Investment Entity is located. However, in each case, one would need to calculate the GloBE income for the Investment Entity. Typically, each Investment Entity could hold hundreds of investments, some of which pay dividends between 1 and 4 times a year, and the Entity also constantly invests/divests, so that the number of transactions in a year typically run to the tens of thousands and for some strategies it could be in the millions or indeed higher.

  The calculation of GloBE income requires identification of 'Excluded Dividends' as per Article 3.1.2 (b) of the Model Rules. These rules refer to Short-term Portfolio Shareholdings which is explained further by way of examples in Chapter 3 of the Commentary (on page 51) as requiring each holding to be reviewed from each distribution date. For MNEs holding numerous positions in Investment Entities that in turn could hold a large number of investments, the examples in Chapter 3 of the Commentary are unworkable in practice. Similarly, calculating an MNE's share of realised gains is likely to cause significant compliance issues. Therefore, a pragmatic approach to calculating profits arising in Investment Entities is needed. One pragmatic solution would be to provide an election to the Investment Entity, or its investors, to mark to market all investments of the Investment Entity to run in parallel with the similar election to treat the Investment Entity as transparent. This would save investment entities and their investors countless hours of unnecessary work and costs.

  Where it is practical to identify portfolio shareholdings, the one-year rule for Excluded Dividends should be modified. An Excluded Dividend is defined, in part, to require economic ownership for at least one year per the Commentary to Article 3.2, requiring equity to be held for a year before the date of distribution (one-year rule). There does not appear to be sufficient reason, however, to distinguish a dividend paid shortly after buying an equity that is then held for over a year. From an administrative perspective, it would be more practical to clarify this one-year rule to mean a holding where the equity is not owned for at least a year that includes the dividend payment date. A similar rule is applied to the 45-day holding period required in the United States to qualify for the dividends received deduction. Additional guidance on applying the one-year rule for tiered structures – where it is unclear whether the rule applies on a look-through basis or only to the direct equity with respect to which the distribution is made – would also be welcomed.

- *Excluded Entity (EE) Definition:* Article 10 of the Model Rules defines Investment Entities by use of the word "and" between conditions (1) and (2) and excludes the indirect ownership reference in the second condition.

  On the use of the word "and," the Commentary appears to confirm that the percentage tests describe different entities and thus are applied in the alternative). See Commentary (pages 21-24).

  On indirect ownership, the Commentary does not clarify the omission in the Article 10 definition of the indirect ownership for the 85 percent owned entity, even though the Article 1.5.2 language makes clear ownership qualifies if owned directly or through a chain of EEs. There appears to be no rationale or guidance in the Model Rules or Commentary to use a different ownership rule for the 85 percent entity test that would limit the rule to first tier subsidiaries. Nonetheless, the Article 10 definition could be interpreted to extend only to an Investment Fund and its first-tier subsidiary. Second-tier subsidiaries might not qualify as an IE, even if they met the ownership and activity tests, because they would not be directly owned.

  Therefore, additional guidance should conform with the Article 1.5.2 language so that ownership in the 85 percent Entity can be direct or through a chain of EEs and not limited to a first-tier subsidiary. Specifically, we request confirmation that conditions (1) and (2) are applied in the alternative and the reference to ownership includes direct and indirect ownership in each condition, despite the use of different language in the Article 1.5.2 and the definition of Investment Entity in Article 10 of the Model Rules.

- *Joint Venture (JV) Entity Rules:* There is a need for clear and practical guidance on how the rules for non-wholly owned entities work in many respects. In particular, we seek clarification on whether:

  (1) An EE, including an Investment Entity, that might also meet the definition of JV continues to be an EE that is not subject to the GloBE rules or must apply the GloBE rules as a JV. The Commentary confirms an EE will not be treated as a JV and thereby addresses the first issue. In particular, para 86 on page 153 of the Commentary provides: "*An Entity is not considered a JV for GloBE purposes if it is an Excluded Entity or the Ownership Interests of the Entity held by the MNE Group are held directly by an Excluded Entity.*" Furthermore, an Entity is excluded from the definition of a JV if it is an Ultimate Parent Entity (UPE) of an MNE Group that is already within the scope of the GloBE Rules because such Group meets the consolidated revenue threshold set out in Article 1.1

  (2) When the GloBE rules apply to the JV, whether the jurisdiction applying the rules is the jurisdiction of the JV entity or the UPE. Para 88 on page 153 (last line) states the JV is only brought into scope of the GloBE with respect to UPE's ownership interest in the JV, suggesting the UPE jurisdiction GloBE rules should apply. However, para 89 on page 153 (lines 7 - 9) states when computing Top-

Up Tax, the JV is treated as the UPE and the JV's accounting standard controls, suggesting the JV jurisdiction's GloBE rules should apply. The uncertainty might be from the operation of the JV rules themselves, wherein a JV computes its liability (under its jurisdiction's rule) and then pushes that result to the UPE to the extent of its ownership interest. Without additional language and examples, this result is unclear, and uncertainty remains.

Examples will greatly assist business to understand how the JV rules are intended to apply and interact with other rules. Among the examples, please include a UTPR calculation in a scenario where the MNE Group's interest in the JV is, at least in part, not subject to a QIIR.

- *Partially Owned Parent Entity (PoPE) Rules:* Where an entity does not fall within the Investment Fund/ EE definition, the PoPE rules could come into play and effectively taint the whole structure to the detriment of minority investors. We are concerned that the application of the PoPE rules to commonly used co-investment structures would not only result in an unfair outcome in the form of compliance costs and double taxation for minority investors, but will also cause uncertainty for fund investors who may not want to invest in such funds where the PoPE rules could apply, or if they choose to invest, they may demand significant warranties to ensure they will bear no tax cost or filing burden as a consequence therefrom. This would be a very difficult representation for a fund manager to make since many funds provide for periodic redemptions or there could be mergers amongst investors (e.g., insurance companies), both of which could alter the ownership structure. This will likely have the effect of weakening the availability and efficiency of investment for key sectors where co-investment is more common such as Infrastructure. We question why minority investors are not hurt where an Intermediate Parent Entity is in an IIR jurisdiction, but minority investors are tainted in a PoPE setting. In order to be consistent with the expressed tax policy objective of tax neutrality for funds, we recommend that Investment Entities with minority investors not be subject to these rules.

- *Domestic Life Companies Holding Funds:* The interaction of the interpretation of the definition of Investment Entities and Insurance Investment Entities and the taxation regime criteria required in order that a tax transparency election can be made is critical for the smooth operation of the regime. The Commentary is helpful in providing guidance relating to the fact that the definition of an Insurance Investment Entity outlined in the Model Rules is narrower than the definition of an Investment Entity. However, this is still an area where further work is required. Also, an election under Article 7.6 does not seem to be available to an Insurance Investment Entity, a result that may cause double taxation, including for policyholders, where an election under Article 7.5 or 7.6 may not be available. Therefore, we urge that the OECD provide additional guidance in this area, in consultation with the industry.

IV. Other Calculation and Administration Issues

- *Guidance Related to U.S. GILTI Rules:* Guidance specific to U.S. tax law and the Global Intangible Low-taxed Income (GILTI) rules is necessary but might depend on whether U.S. legislation makes changes to the GILTI rules that make it a qualified IIR. The uncertainty of whether U.S. tax legislation will be enacted may not be resolved until later this year. The OECD must be flexible in determining the guidance that is necessary, allowing additional input from stakeholders as this implementation framework is developed. Specifically, guidance is necessary to specify if GILTI will be determined to be a qualified IIR. If GILTI is not qualified, confirmation is needed that it qualifies as a CFC regime. While the Commentary clarifies that a peer review process will be created to determine whether regimes will qualify, US MNEs require certainty well before such a peer review process is established.

- *Allocation of cross-border taxes:* Further guidance and examples should be provided on allocating cross border taxes in the context of tax transparent entities and CFC regimes that is required to determine the calculation of an entity's ETR in jurisdictions with cross crediting.

- *QDMTT Issues:* We are concerned that the potential adoption of a QMDTT by many jurisdictions could result in double taxation. The recently released Commentary provides very little additional guidance as to the operation of QDMTTs within the GloBE framework, including consistency with GloBE outcomes and, for instance, how CFC Taxes will serve as part of Covered Taxes in the context of a QDMTT regime (recognizing that not all countries will adopt qualifying IIRs and UTPRs). Moreover, additional rules addressing the workings of the QDMTT, in particular providing further guidance relating to rule ordering with respect to domestic tax rules when there is no qualifying IIR.

  In addition, it is important that the treatment of EEs and Investment Entities for the IIR and UTPR should apply equally to any particular country's QDMTT regime. For example, if a QDMTT applies in cases where a fund structure inadvertently fails the 95% or 85% ownership tests under the Investment Fund definition, all fund investors will bear Pillar Two consequences. To address this, Investment Entities should be excluded from the application of the QDMTT, or at the very least, Investment Entities should be given an opportunity to cure the problem, within a prescribed period or pursuant to a 'good faith' determination.

  Finally, the definition of a QDMTT in the Model Rules enables jurisdictions to permit MNEs to compute the domestic top-up tax based on the local accounting standard in their jurisdiction, rather than the standard used by the ultimate parent. No jurisdiction should be permitted to determine which standard is used but rather be required to allow an election of which standard to use as the tax base for its QDMTT. Moreover, when the tax base of the QDMTT is the same as that for the IIR and UTPR, only one set of calculations should be needed. Allowing taxpayers to use their IIR (or UTPR) calculations for QDMTT would avoid duplication of compliance costs.

- *Simplification for filing of Information Return:* According to Article 8.1 of the Model Rules, the primary filing obligation is with each Constituent Entity (CE). This obligation is only waived in the event that a GloBE Information Return conforming with the requirements is filed by the UPE or a Designated Filing Entity of a MNE Group, both having to file with their respective Competent Authorities that have a Qualifying Competent Authority Agreement in place. The term Qualifying Competent Authority Agreement is defined as a bilateral or multilateral agreement or arrangement between Competent Authorities that provides for the automatic exchange of annual GloBE Information Returns. Given that the Convention on Mutual Administrative Assistance in Tax Matters (MCAA) is a framework agreement only, it is our understanding that a separate agreement would have to be put in place that specifically addresses the international exchange of annual GloBE Information Returns. It is critical that the OECD accelerates the implementation of the Qualifying Competent Authority Agreement so that local-to-local filing obligations can be avoided.

- *GloBE Income Calculation and Financial Statements:* The information included in consolidated financial statements are almost invariably different from the year-end local financial statements, due to year-end adjustments and materiality, etc. Typically, consolidated financial statements are prepared in a compressed timetable post the financial year-end. Whilst these figures are subject to audit, group level materiality typically runs at around 5% of profit. As a result, there are likely to be significant discrepancies between entity figures used for consolidated accounts purposes and entity numbers used for the statutory accounts process that takes place later in the year (and for any local corporate tax filings). In effect, the GloBE rules as drafted are requiring MNEs to accurately compute covered taxes for all of their jurisdictions within that very truncated year-end period (typically only a couple of weeks). The resultant inaccuracies will cause significant problems. To the extent that tax is incorrectly calculated as too low, the result may be a top-up tax that is unfairly and inaccurately charged. To the extent that tax is incorrectly calculated as too high, the GloBE calculations may need to be resubmitted. A GloBE reporting deadline of 15-18 months after year end does not address the time constraints associated with the preparation of consolidated financial statements.

Therefore, the Implementation Framework should clarify that, where entity accounts are prepared using the same acceptable GAAP as the consolidated accounts, these accounts should be treated as an acceptable starting position for GloBE purposes as long as the approach is applied consistently. This approach would align the GloBE tax basis with the starting point for most tax returns. At a minimum additional guidance is necessary to inform MNEs on how to derive Financial Accounting Net Income or Loss at the CE level, taking into account the many adjustments that rise within a set of Consolidated Financial Statements that exist in practice but have not been contemplated in the guidance to date. By way of illustration, late accounting adjustments will often not be posted to the individual CE accounts as the local books will have been closed but to a notional entity as part of the consolidation process. That adjustment will subsequently be posted to the relevant entity as part of the statutory reporting process of that entity.

Clarification would also be welcome on the use of financial statements of the local entity when the local entity has a different year end then that of the UPE. The country-by-country reporting (CbCR) guidance does comment on this and allows businesses to use different year ends. A similar approach should be adopted for GloBE purposes.

- *Deemed Consolidation Rules:* The Model Rules state: *"Where the Ultimate Parent Entity does not prepare financial statements described in the paragraphs above, the Consolidated Financial Statements of the Ultimate Parent Entity are those that would have been prepared if such Entity were required to prepare such statements in accordance with an Authorised Financial Accounting Standard"*

  The above seems to hypothesise that consolidated financial statements are required though the relevant GAAP does not provide for it and doing so is inconsistent with the CbCR rules. The CbCR rules only require the reporting of consolidated group numbers if the group actually is required to prepare them under the relevant GAAP or would be so required if equity interests of any group member or members were publicly traded on a securities exchange. Typically, under relevant GAAP, an entity which is an Investment Company is not permitted to consolidate subsidiaries. This is, in part, because the Investment Company is not considered to be engaged in a trade or business and requiring consolidation with an operating business would not be appropriate or fair to users of financial statements. Accounting rule makers, thus, prohibit such consolidation. Given the underlying policy of Pillar Two, the deference accorded relevant GAAP rules in the Pillar Two Model Rules, and the OECD's long-standing express tax neutrality principle intended to apply to funds, we see no reason to require 'deemed consolidation' in a fund context. From a fund perspective, the deemed consolidation rules in the Model Rules could *prima facie* inadvertently sweep up portfolio entities in a fund structure within the scope of Pillar Two, despite these entities not actually being a part of an MNE's group. We therefore request that the CbCR deemed consolidation rules be applied to ensure wider consistency.

- *Scoping Threshold Issues:* In general, operational rules to adjust income is limited to measuring the ETR and not relevant to measuring the 750M € threshold of the MNE Group. For certain subsidiaries of EEs, an assessment of ownership, activities, and amount of income must also be measured. As noted below, particular scenarios require additional confirmation to be able to make these assessments.

Revenue thresholds scenarios:

(1) Where an entity (Entity 1) owns a 30% ownership interest in another entity (Entity 2) that it controls (i.e., Entity 2 would be a minority-owned CE (MOCE) if it were a constituent entity of a MNE Group). Further guidance should confirm, as implied in the Commentary, whether 100% of the revenue of Entity 2 is counted toward the 750m Euro threshold. Any other interpretation would seem incorrect.

(2) Where an entity has a wholly owned foreign subsidiary that holds no assets other than equity interests accounted for using the equity method or fair value method of accounting. Additional guidance should also confirm that the revenue recorded using the equity method or fair value accounting is counted toward the 750m Euro threshold, even though that revenue would be excluded from GloBE Income. To do otherwise would create an inconsistent outcome.

Excluded Entity Thresholds

(1) In determining whether the ownership and activity tests have been met for IE to be an EE under Article 1.5.2, further guidance should address how certain economic interests held in the chain impact these requirements. For example, amounts related to the carry might be held throughout a multi-tier structure and cause a reduction in the ownership below the 95 and 85 percent thresholds. Paragraph 49 of the Commentary explains the value of the entity differs from the ownership interest in the entity. While the Commentary makes clear the lower percentage in the 85 percent test is intended to provide greater flexibility in the context of vehicles held by Investment Funds (e.g., where third parties may hold a greater stake or where interests in the vehicle are held by management and employees), the rule translates into limiting the value of the carry in such entities to well below 15% if not held at the top of the structure. This application might not be reasonable in practice.

(2) As explained in the Commentary, the 85 percent threshold can be met when a small amount of the entity's income is not from Excluded Income through the use of the substantially all standard. However, in determining whether substantially all of the Entity's income is Excluded Income, additional guidance should be provided to moderate the rule for entities that will have dividend and equity returns that might not meet the Excluded Income definitions (including Short-Term Portfolio Holdings).

V. Conclusion

SIFMA AMG and the IA appreciate the opportunity to submit these comments on the Implementation Framework Pillar Two consultation. We recognize and appreciate the considerable time and energy that the Secretariat and delegates have devoted to understanding the unique and sometimes complex operations of investment funds. Your focus on these issues over the last two years has been incredibly important in ensuring that the Pillar Two rules recognize the importance of maintaining the tax neutrality of investment funds, and the risks of not protecting the tax neutrality of investment funds.

It is critical that investment funds are not inadvertently subjected to Pillar Two, including any QDMTT, in order to maintain the basic principles of tax neutrality for such structures. At the same time, implementation of the complex Pillar Two rules must not be rushed and must be thought through carefully. In short, the IA and SIFMA AMG stand ready to continue to work with the OECD as countries transpose the Model Rules and Commentary into their domestic law to ensure the implementation of the rules in regards to Investment Funds is clear and consistent throughout the world.

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We thank you for your consideration of these comments. Please contact Anshita Joshi at the IA anshita.joshi@theia.org), Justin Sok at SIFMA (jsok@SIFMA.org), (Jeff Levey (Jeff.Levey@ey.com) or Rebecca Burch (Rebecca.burch@ey.com) via email if you have any questions regarding this submission.

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