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Paris, France

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Dear Sirs and Mesdames,

We are writing in response to the OECD's invitation to comment on its Public Consultation Document "Global Anti-Base Erosion Proposal ('GloBE') – Pillar Two", released November 8, 2019 (the "**Consultation Document**"). The signatories to this letter represent pension funds, similar government-related funds, and other sovereign wealth funds ("**SWFs**"). The issues raised by the Consultation Document and by the work on Pillar Two more broadly are of great importance to pension funds and SWFs worldwide.

We recognize the tax policy objectives underlying Pillar Two and the GloBE proposal and have sought to respect these objectives as part of the comments and proposals in this letter. We are keen to work with the OECD to explore solutions that take into account our concerns and particular circumstances, while also addressing national governments' tax policy concerns.

Executive Summary

Pension funds and SWFs are established to achieve certain policy goals, such as providing for the future welfare or income security of their constituents or beneficiaries. As discussed in more detail below, pension funds and SWFs do not implicate the stated policy objectives of the GloBE proposal; however, the GloBE proposals as described in the Consultation Document may apply to impose significant additional tax on pension funds and SWFs, because they generally are tax-exempt or subject to reduced tax.

We do not think that this result is intended, and we suggest that a carve-out from the GloBE proposal for pension funds and SWFs would be appropriate, for example by deeming income or payments received directly or indirectly by pension funds or SWFs to have been subject to the agreed minimum rate of tax. We also suggest that the investment entities through which pension funds and SWFs invest should be excepted from the GloBE proposal, given that the tax treatment of investment entities generally is intended to avoid creating an additional level of tax between the underlying investment and the investor.

More generally, we suggest that the GloBE proposals should only apply to entities that are members of a group that prepares consolidated financial statements, which is the standard that was adopted for country-by-country reporting ("**CBCR**"). Limiting the scope in this way would help ensure that the proposals apply only to entities that have the control and information needed to comply with the proposals.

Purposes and Significance of Pension Funds and SWFs

The pension fund and SWF community has been actively engaged with the OECD since the beginning of the BEPS project, and has been supportive of the tax policy aims of governments while also trying to ensure that the policy goals behind the establishment of pension funds and SWFs are taken into account. As discussed in prior submissions,[1] pension funds and SWFs are established to accomplish long-term public policy goals and have long-term obligations and commitments to their respective beneficiaries and constituents, such as, but not limited to, the funding and provision of pension benefits or social programs for current and future generations. Consequently, such investors generally are exempt from income tax (or taxed at a reduced rate) in their home jurisdictions, having been granted such benefits in order to allow them to fulfill their domestic public policy objectives. This residence jurisdiction tax exemption or reduction for pension funds and SWFs is not similar in purpose or effect to inefficient tax incentives or harmful preferential tax regimes, which are designed to attract tax base to a jurisdiction.

A number of governments also provide reciprocal exemptions for pension funds in their bilateral tax treaties, and some jurisdictions also exempt certain foreign government-owned entities. These exemptions for foreign pension funds and SWFs are a recognition that such exemptions can both help their resident pension funds or SWFs meet their policy objectives and stimulate investment from foreign pension funds and SWFs.

Pension funds and SWFs also are an increasingly important source of global investment capital.[2] Pension funds and SWFs support various sectors of the economy around the world such that spending on infrastructure, public services, and social support does not solely rely on government expenditure. In addition, given their long-term investment horizon, pension funds and SWFs add stability to the global economy during periods of significant financial stress. They thereby contribute to the economic development of source countries.

Pension funds and SWFs increasingly invest significant portions of their portfolios in foreign markets. For example, based on the OECD's most recent annual survey, all large pension funds based in the OECD invested at least part of their portfolios in foreign markets, although absolute levels of foreign investment varied widely, between 89.6% at the highest to 7.0% at the lowest.[3] As indicated in prior submissions, [4] in recent years pension funds and SWFs also have diversified their portfolios beyond bonds and equities by adding allocations to alternative investments such as real estate, infrastructure, agricultural, private equity, and hedge funds (described as "Non-CIVs" in prior OECD documents).[5]

The GloBE proposals therefore could significantly and adversely impact pension funds and SWFs, given that the GloBE proposals would impose additional tax on income or payments that are considered not to be subject to a minimum level of taxation. Pension funds and SWFs generally are tax-exempt or taxed at a reduced rate in their home jurisdictions, and therefore the GloBE proposals *prima facie* would apply to impose additional tax on them. As described in more detail below, we do not think that pension funds and

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[1] *See, e.g.*, Comments Received on Public Discussion Draft, Follow-Up Work on BEPS Action 6: Prevent Treaty Abuse, BIAC consensus responses to OECD Discussion Draft, Canadian Pension Funds, Queensland Investment Corp and New Zealand Superannuation, PGGM & APG, *available at http://www.oecd.org/ctp/treaties/public-comments-action-6-follow-up-prevent-treaty-abuse.pdf.*

[2] *See* OECD (2018), Annual Survey of Large Pension Funds and Public Pension Reserve Funds: Report on Pension Funds' Long-Term Investments, 2016, www.oecd.org/finance/survey-large-pension-funds.htm.

[3] *Id*. at 17.

[4] *See* Comments Received on Public Discussion Draft, BEPS Action 6 – Examples on Treaty Entitlement of Non-CIV Funds, *available at http://www.oecd.org/ctp/treaties/Non-CIV-Examples-Compilation-of-Comments.pdf.*

[5] *See* OECD, Public Discussion Draft "BEPS Action 6: Discussion Draft on non-CIV examples" (January 2017), *available at* http://www.oecd.org/tax/treaties/Discussion-draft-non-CIV-examples.pdf.

SWFs should be subject to the rules of the GloBE proposal, because they do not implicate the stated policy concerns motivating the GloBE proposal; indeed, application of the GloBE proposal to such investors may lead to incongruous results.

Pension Funds and SWFs Do Not Implicate Policy Concerns of GloBE Proposal

Stated Purposes of Pillar Two

In its "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy" released May 31, 2019 (the "**Programme of Work**"), the OECD states that the GloBE proposal is based on the premise that in the absence of multilateral action, there is a risk of a harmful race to the bottom for corporate income tax rates, as countries compete to attract and retain tax base. Without a multilateral framework, countries may increasingly feel pressured to offer inefficient tax incentives, and revenue forgone from tax incentives may reduce opportunities for much-needed public spending on infrastructure, public services or social support. The GloBE proposal seeks to limit the distortive impact of direct taxes on investment and business location decisions and provide a backstop to Pillar One for situations where profits are booked in a tax environment below the minimum tax rate.[6] The Programme of Work further states that the GloBE proposal is intended to help address the remaining BEPS challenges linked to the digitalising economy, where the relative importance of intangible assets as profit drivers makes highly digitalised business often ideally placed to avail themselves of profit shifting planning structures. The GloBE is not limited to highly digitalised businesses, however; it is designed to ensure that all internationally operating businesses pay a minimum level of tax.[7]

Application to Pension Funds and SWFs

The policy concerns that the GloBE proposal is intended to address are simply not relevant in the context of pension funds and SWFs. There is no race to the bottom for the taxation of pension funds and SWFs – many jurisdictions already exempt their own pension funds and SWFs. Jurisdictions do not provide tax benefits or exemption for pension funds or SWFs to attract tax base; rather, jurisdictions provide tax benefits or exemption for pension funds and SWFs to accomplish other policy goals, such as providing for the future welfare or income security of their populations. The tax exemption or reduction afforded pension funds and SWFs thus should not be equated with inefficient incentives or considered a harmful preferential tax regime. In addition, pension funds and SWFs are not "operating businesses" targeted by the GloBE proposal, but instead hold investments for the benefit of their constituencies or beneficiaries. Pension funds and SWFs (themselves, as opposed to the operating businesses in which they invest) also do not own intangibles that could be used to shift profits. Because pension funds and SWFs do not implicate the stated policy concerns that motivate the GloBE proposal, pension funds and SWFs should not be subject to its rules.

Applying the GloBE proposal to tax the income of an exempt pension fund would result in double taxation in many cases. If a source country imposes tax on income of the pension fund, there generally is no mechanism for the pension fund to offset the tax in its residence jurisdiction (because the pension fund is exempt from tax in its residence jurisdiction). The beneficiaries may then be taxed again on the distributions they receive from the pension fund, generally with no ability to credit the amount of the source jurisdiction tax, thereby resulting in double taxation. We do not believe that such double taxation is intended or appropriate in the context of the GloBE proposal.

Moreover, subjecting pension funds and SWFs to the rules of the GloBE proposal may lead to incongruous results. Many of the signatories to this letter are funded in whole or in part by the governments of their respective jurisdictions. Subjecting these organizations to the income inclusion rule would create an absurd result in which the organizations would have to pay additional taxes to the governments of their residence

[6] *See* Programme of Work, ¶ 54.

[7] *See* Programme of Work, ¶¶ 53 and 55.

jurisdictions, and those governments would have to increase their contributions (if possible) to the organizations in order to meet the policy goals for which they were established. Similarly, if the undertaxed payments rule and subject to tax rule otherwise would apply to pension funds and SWFs, the governments of the residence jurisdictions could turn off the application of those rules by imposing a tax on the payments otherwise subject to those rules, but then may be forced to increase their contributions to the funds. In other words, subjecting pension funds and SWFs to the rules of the GloBE proposal would, absent other offsetting government actions or expenditures, have an adverse impact on the ability of governments to meet the long-term objectives for which they established the pension funds and SWFs.

The Consultation Document also notes that the GloBE proposal may impact on activities generating positive or negative externalities.[8] The activities of pension funds and SWFs often create positive externalities in both residence and source jurisdictions. With respect to their residence jurisdictions, pension funds and SWFs are created to fund the long-term welfare or income security of their beneficiaries or constituents. That security allows for greater economic activity that produces benefits even for those who are not beneficiaries of the particular fund. Similarly, pension funds and SWFs often invest in infrastructure or other long-term assets that can increase economic activity and efficiency in source jurisdictions, thereby generating positive economic externalities. Pension funds and SWFs bear the risk of loss from these investments; to subject them to greater source country taxation solely because their residence jurisdictions provide a tax exemption would create disincentives to take on these long-term investments.

We also note that the special policy considerations relating to pension funds and SWFs have generally been recognized in international tax law. For example, the OECD Model Tax Convention on Income and on Capital (the "**Model Treaty**") specifically provides that a recognised pension fund is a resident for treaty purposes, even if the pension fund benefits from a limited or complete exemption from taxation.[9] Similarly, an SWF often will qualify for treaty benefits as a resident of its jurisdiction.[10] In addition, in the final report on Action 2, the OECD explained in Example 1.5 that an interest payment deductible in the source jurisdiction and not taxable to a SWF recipient in the residence jurisdiction does not create a mismatch for purposes of the hybrid financial instrument rule.[11] Because the mismatch is attributable solely to the recipient's tax-exempt status, and is not dependent on the terms of the underlying instrument, the mismatch in tax outcomes is not subject to the anti-hybrid rule. In other words, there are multiple precedents for addressing the tax policy considerations relevant to pension funds and SWFs, and we believe that the GloBE proposal also should specifically address those considerations.

GloBE Proposal Should Not Apply to Pension Funds and SWFs

For the foregoing reasons, we believe that the GloBE proposal should not apply to pension funds and SWFs. The most direct way to accomplish this would be through an explicit carve-out for pension funds and SWFs. Such an exemption also should apply to investment entities through which pension funds and SWFs invest. In addition or alternatively, pension funds and SWFs could effectively be exempted from the GloBE proposal by limiting the proposal to large, consumer-facing businesses, as with the Secretariat's proposal for a "Unified Approach" to Pillar One.[12]

[8] *See* Consultation Document, ¶ 77.

[9] *See* Model Treaty (2017 version), Art. 4(1); Commentary on Article 4 of the Model Treaty, ¶ 8.6.

[10] *See* Commentary on Article 4 of the Model Treaty, ¶¶ 8.5, 8.11.

[11] *See* OECD, "Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2: 2015 Final Report" (2015). www.oecd.org/tax/neutralising-the-effects-of-hybrid-mismatch-arrangements-action-2-2015-final-report-9789264241138-en.htm.

[12] *See* OECD, Secretariat Proposal for a "Unified Approach" to Pillar One, *available at* *http://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf*. As discussed above, pension funds and SWFs are not businesses, and clearly are not consumer-facing. Limiting the scope of the GloBE proposal to consumer-facing businesses thus would exclude pension funds and SWFs, but would retain in scope many of the businesses in which they invest. The benefits and challenges of such a scope have been discussed extensively in the context of Pillar One, and we do not discuss them further here.

Exemption for Pension Funds and SWFs

The Consultation Document requested comments regarding potential carve-outs from the GloBE proposal.[13] For the reasons discussed above, we respectfully suggest that pension funds and SWFs should be carved out of the GloBE proposal. Specifically, we believe residence jurisdictions should exclude from the income inclusion rule recognised pension funds, as defined in the Model Treaty, and SWFs, defined as "any State or an entity directly or indirectly wholly owned by a State, any political subdivision, agency or instrumentality of the State or local authority of the jurisdiction in which the entity is resident". Source jurisdictions also should exclude from the undertaxed payments rule and the subject to tax rule: (i) payments directly received by a recognised pension fund or SWF, even if the payor is wholly owned by the recognised pension fund or SWF; and (ii) payments received directly by entities that are directly or indirectly wholly owned by one or more recognised pension funds or SWFs. Pension funds and SWFs often invest through investment entities due to regulatory requirements, lender requirements, or a need to pool capital with other investors. Subjecting the earnings of those entities to additional source country tax would eviscerate the exemption for pension funds and SWFs and decrease the positive economic externalities created by the activities of pension funds and SWFs in both residence and source jurisdictions.

One way to accomplish the exclusion would be to deem any income or payment received directly or indirectly by a recognised pension fund or SWF to have been subject to tax at the agreed minimum rate. Such a deeming rule would avoid the potential for double taxation and would ensure the protection of both the policy goals of the GloBE proposal and the policy goals underlying the tax treatment of pension funds and SWFs.

Treatment of Investment Entities

As others have argued in the context of the Pillar One proposal, investment entities generally are intended to be treated as tax neutral (*i.e.*, they are intended not to result in an additional level of tax between the underlying investment and the investor), and investment entities do not conduct operating businesses. Accordingly, we believe it would be appropriate to provide an exemption from the GloBE proposal for investment entities that achieve tax neutrality for their investors.

In an overwhelming number of jurisdictions, the tax treatment of investment entities is designed to treat investments made through investment entities in a manner comparable to a direct investment, so that those entities may serve as efficient vehicles for pooling capital. This tax neutrality is achieved by either: (i) treating the investment entity as fiscally transparent, in which case the investors are taxed on the income of the investment entity; or (ii) treating the investment entity as opaque (to a greater or lesser degree) but providing an exemption for the investment entity or reducing the investment entity's taxable income by, *e.g.*, the distributions made by the investment entity.

The OECD has previously recognized the important non-tax purposes served by many investment entities.[14] Subjecting all investment entities to the GloBE proposal would risk distorting capital markets and disrupt the widely accepted principle that fund investors should be no worse off investing through a fund than if they had invested directly. Thus, we believe investment entities that achieve tax neutrality for their investors should be exempt from application of the GloBE proposal, so that the GloBE proposal does not create an additional level of tax between the underlying investment and the investor.

[13] *See* Consultation Document, Part 4.

[14] *See, e.g.*, OECD, The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles (2010).

Limit GloBE Proposal to Groups Preparing Consolidated Financial Statements

More generally, we support the GloBE proposal applying only to multinational groups that prepare consolidated financial statements (or that would prepare such statements if the ultimate parent entity were publicly traded), though we note that such an approach by itself is only a partial solution for pension funds and SWFs.[15] Limiting the GloBE proposal in this way would help ensure that the rules only apply to entities that have sufficient control and information to be able to apply the rules.

Specifically, we suggest that the income inclusion rule should only take into account income of a foreign branch or a foreign controlled entity that is included in the consolidated financial statements of the parent entity. Similarly, we suggest that the undertaxed payments rule and subject to tax rule should apply only to payments between entities that are included in a group that prepares consolidated financial statements.

We note that the Consultation Document suggests that the tax base under the GloBE proposal might depend in part on consolidated financial statements, which would further support limiting the proposal to groups that prepare consolidated financial statements. Specifically, the Consultation Document suggests that it may be appropriate to determine the tax base for purposes of the GloBE proposal based on relevant accounting rules, subject to any agreed adjustments to align accounting income with a proper measure of taxable income. The Consultation Document suggests that such an approach could improve compliance and administrability and neutralise the impact of structural differences in the calculation of the tax base.

We agree with the Consultation Document's assessment that using global consolidated financial statements as the starting point for determining the tax base under the GloBE proposal would improve compliance and administrability. Assuming that consolidated financial statements are the basis for calculating the tax base under the GloBE proposal, the rules should be limited to groups that prepare consolidated financial statements, to ensure that taxpayers subject to the rules have the information necessary to apply the rules. Applying rules only to groups that prepare consolidated financial statements has been used successfully in the CBCR rules, and has the benefit that taxpayers and tax administrations generally know how to administer it.[16]

Limiting the GloBE proposal to groups that prepare consolidated financial statements would exclude many investments by pension funds and SWFs, because in most cases under current accounting rules the entities that hold pension fund and SWF investments do not fully consolidate with the underlying investments; rather, they account for those investments at fair value under the equity method or another similar construct. This accounting treatment reflects the fact that the investment entity is not operating the business of the underlying investment. By contrast, many pension funds and SWFs have entities that provide investment management or advisory services. Those management entities generally do consolidate with one another. Thus, limiting the scope of the GloBE proposal in this way would sweep out of scope payments between a portfolio investment and the pension fund or SWF, but would leave in scope the underlying businesses in which pension funds and SWFs invest, as well as potentially the management entities of pension funds and SWFs.

Indeed, the OECD's guidance regarding implementation of the CBCR rules provides clear guidance on how investment entities (which would include pension funds and SWFs and the entities through which they invest) are treated under an approach that is limited to groups that prepare consolidated financial statements:

[15] For purposes of this letter, when we refer to groups "that prepare consolidated financial statements" we intend also to include groups that would prepare consolidated financial statements if the ultimate parent entity were publicly traded, unless the context otherwise requires.

[16] OECD, "Guidance on the Implementation of Country-by-Country Reporting" (June 2016), *available at* www.oecd.org/tax/beps/guidance-on-the-implementation-ofcountry-by-country-reporting-beps-action-13.htm, and December 2016, www.oecd.org/tax/guidance-on-the-implementation-of-country-by-country-reporting-bepsaction-13.pdf.

> [*I]f the accounting rules instruct investment entities to not consolidate with investee companies (e.g. because the consolidated accounts for the investment entity should instead report fair value of the investment through profit and loss), then the investee companies should not form part of a Group or MNE Group (as defined in the model legislation) or be considered as Constituent Entities of an MNE Group. This principle applies even where the investment entity has a controlling interest in the investee company.*
>
> *On the other hand, if the accounting rules require an investment entity to consolidate with a subsidiary, such as where the subsidiary provides services that relate to the investment entity's investment activities, then the subsidiary should be part of a Group and should be considered as a Constituent Entity of the MNE Group (if one exists).*[17]

Following the same principle in the GloBE proposal, if a pension fund or SWF did not consolidate with an investee company, and instead reported the fair value of the investment, the pension fund or SWF would not include the income of the investee company under the income inclusion rule. Similarly, a payment by the investee company to the pension fund or SWF would not be subject to the undertaxed payment rule or subject to tax rule.

Responses to Other Questions from Consultation Document

In response to the questions in the Consultation Document regarding the use of financial accounts as the starting point for determining the tax base, we assume for this purpose that the GloBE would be limited to groups that prepare consolidated financial statements. In that case, we believe that the accounting standards used by the group to prepare its consolidated financial statements should be used, irrespective of whether that standard conforms to International Financial Reporting Standards, to avoid the need for the group to retain multiple sets of books.

In addition, the financial accounting income should not be adjusted to a mythical universal tax base. Countries have different tax systems, and trying to define a universal common tax base toward which the accounting income would have to be adjusted would unnecessarily bog down the work on the GloBE. Adjustments also would require taxpayers to keep a third set of books, because the adjusted tax base would not conform to either the accounting income or to taxable income generally.

Conclusion

For the reasons set forth above, we believe that pension funds and SWFs do not raise the policy concerns that motivate the GloBE proposal, and we therefore respectfully suggest that they and the entities through which they invest should be carved out of the scope of the GloBE proposal. We appreciate the opportunity to comment on the Consultation Document, and look forward to working with the OECD to develop administrable solutions to the issues presented by the GloBE proposal. Should you have any questions or comments regarding these matters, please do not hesitate to contact us.

Sincerely,

On behalf of the parties named above.

[17] OECD (2018), Guidance on the Implementation of Country-by-Country Reporting – BEPS Action 13, Part III, Question 1.