4 April 2022

By email: PillarTwoConsultation@hmtreasury.gov.uk

Dear colleagues

OECD Pillar 2 Consultation on implementation

We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 750 firms, we represent the vast majority of all UK-based private equity and venture capital firms, as well as their professional advisers and investors. Between 2016 and 2020, BVCA members invested over £47bn into around 3,500 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ over 1.1m people in the UK and 90% of the businesses our members invest in are small and medium-sized businesses.

The BVCA welcomes the opportunity to respond the "OECD Pillar 2 – Consultation on implementation" published by HMRC and HM Treasury on 11 January 2022 (the "Consultation") regarding the introduction into UK law of the "OECD Global Anti-Base Erosion Model Rules (Pillar Two)" published by the OECD on 22 December 2021 (the "Model Rules"). Unless otherwise stated capitalised terms in this letter take their definition from the Model Rules.

General points

The implementation of the Model Rules is a hugely significant and complicated undertaking and we are concerned that, while the UK is keen to promptly respond to global anti-abuse initiatives, the proposal to introduce legislation in 2022 to take effect in 2023 is inappropriate both generally and in the more specific context of investment funds. We would strongly urge the Government to delay these measures by at least a year and to suggest that the OECD adopts a similar delay. In this regard, we note that the European Union has already amended its draft directive relating to the Model Rules and now proposes implementation of the Income Inclusion Rule for tax years beginning on or after 31 December 2023.[1] We consider this to be an extremely important point for the reasons set out below.

The Model Rules operate within a framework which is still subject to significant uncertainties. The treaty based Subject To Tax Rules ("STTR") forming part of Pillar Two are yet to be published. An OECD public consultation on an international framework on administrative, compliance and co-ordination issues relating to Pillar Two was issued on 14 March 2022 and comments are due by 11 April 2022 with a view to a meeting at the end of April 2022. The safe harbours under consideration offer potentially significant simplification; therefore early implementation by the UK without these measures will mean UK based businesses will be placed at a disadvantage given the need to prepare for the "worst case scenario". The OECD commentary to the Model Rules (the "Commentary") was also released on March 14, 2022 and is the subject on ongoing consideration and comment. The Model Rules do not exist in a vacuum and it would seem wise to await further developments in these related areas before introducing legislation to implement the Model Rules in the UK. We are not suggesting that the foregoing matters need to be finalised but there needs to be more information about them before the UK legislates in this area. Experience with the hybrid mismatch rules supports a more measured

[1] Subject to approval from ECOFIN which is anticipated.

British Private Equity & Venture Capital Association
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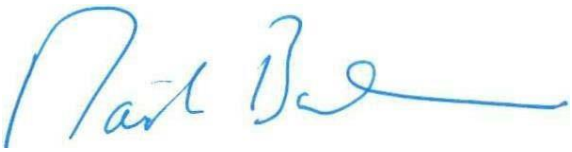
approach in complex circumstances. The UK introduced hybrid mismatch rules at an early stage and without time for due reflection; in consequence, there has been significant uncertainty for taxpayers and the necessity for backdated amendments to address areas of deviation from the intention of the OECD. This is inevitable when extremely complicated rules are introduced without sufficient opportunity for them to be fully considered. This should not be repeated in this case.

Early introduction of the Model Rules will place greater administrative burdens on UK operations, subject UK parent entities to tax which will not be payable at such an early stage elsewhere and expose UK businesses to the cost and complexity of managing uncertain positions which may have been resolved by the time similar rules apply in other jurisdictions. Collectively, these factors will render the UK uncompetitive. The Government has made considerable, and appreciated, efforts to position itself as an attractive jurisdiction for investment funds and their platforms and this would be undermined by an unnecessarily accelerated approach to implementing the Model Rules.

In relation to investment funds more specifically, we consider it essential that lingering uncertainty in the Model Rules on their intended scope is fully clarified before the Government embarks on legislation of this nature. Our starting point is that investment fund structures do not generally consolidate below the fund due to specific exemptions for investment entities provided for in most GAAP rules. However, there is some uncertainty around the meaning behind the definition of "Consolidated Financial Statements" and it is extremely important that this is clearly addressed. As drafted, the Model Rules (see Article 10.1.1 definition of Consolidated Financial Statements at (d)) seem to provide that, even where the relevant Authorised Financial Accounting Standard would not require it, an UPE is deemed to have prepared financial statements on a consolidated basis as if its Authorised Financial Accounting Standard had required it. We do not believe that this is intended but it is significant for funds in that it could, inadvertently bring portfolio companies in a fund structure within the scope of the Model Rules. It is also inconsistent with the equivalent rules on Country-by-Country Reporting ("CbCR") which only require consolidation if actually required by relevant accounting rules. As is alluded to in the Commentary on this point (see paragraphs 10-13) and in the Consultation (see 4.6), it seems to be the intention to align the Model Rules with CbCR. Accordingly, our expectation would be that, in a large part, fund investment structures will not be affected by the Model Rules on the basis that they will not meet the requirement to prepare consolidated financial accounts for their overall groups or portfolio companies. Our understanding is that this is, indeed, intended and it should be confirmed in advance of UK legislation being introduced.

Please let us know if you have any comments or questions and we would very much welcome the opportunity to discuss and review the draft provisions to ensure they continue to meet the objectives discussed above.

Yours faithfully,



Mark Baldwin

Chairman of the BVCA Taxation Committee

A.1 Chapter 3: Common approach

1. Do you see any strong reason why UK legislation should not follow the OECD Model Rules as closely as possible to ensure consistency bearing in mind the limited flexibility permitted by the common approach?

We consider it to be important that the UK largely follows the principles of the OECD intentions behind the Model Rules. This means that, as indicated above in the context of Consolidated Financial Statements, the law reflects the overall intention (in this case to follow CbCR), especially where deviations from such intention can be detected in the actual wording of the Model Rules. We also consider it to be important that the UK introduces some variation to the rules where it is required to maintain the integrity of specific regimes or tax incentives in the UK or where UK law requires it as a matter of clarity. An example would be in relation to the QAHC regime (as set out below). However, we are confident that there would be wider examples. Overall, it is important that any legislation is considered with due care and that UK law does not merely replicate the Model Rules.

2. Do respondents have any views on how the common approach can be more effectively achieved at a global level?

As stated above, we consider that a delay should be considered at a global level. The timescale currently suggested is inappropriate for such a complex set of proposals.

A.2 Chapter 4: Scope

3. Do respondents have any comments on the calculation of the €750m consolidated revenue threshold?

As stated above, we consider that the definition of Consolidated Financial Statements needs to be aligned with CbCR. The Consultation (at 4.6) appears to accept this.

4. Do respondents agree the IIR should only apply to groups that meet this threshold?

Yes.

5. Do respondents have any comments on the definition of a group or of a constituent entity?

Some attention should be given to the precise treatment of partnerships. A partnership is stated to be an "Entity" within the Model Rules (see Article 10.1.1). Partnerships are treated as resident where "created" if UPE of an MNE Group (see Article 10.3.2). Otherwise they are treated as "stateless" so that the rules are applied in the jurisdiction of the partners. However, the term UPE requires a Controlling Interest and a Controlling Interest requires an Ownership Interest which is an equity interest requiring a right to profits, capital or reserves. This may, technically, be difficult in the context of partnerships such as English partnerships, which are merely a description of relation between the partners, not something which readily lends itself to equity ownership. This is a frequent issue in rules prepared by the OECD which does not tend to understand Anglo Saxon partnerships well, but it should be addressed in the UK.

6. Do respondents have any comments on the excluded entity rules and definitions?

Although we appreciate it is enshrined in the Model Rules, we do not understand the rationale for an Investment Fund only being an Excluded Entity if it is a UPE. This seems to be an unnecessary limitation. The Commentary (at paragraph 42) alludes to the fact that, even if not Excluded Entities, funds are likely to be Investment Entities and thus subject to the specific rules relating to these. However, this seems to add unnecessary complexity and it would seem more appropriate (and not inconsistent with the policy behind the Model Rules) to adopt a more general definition of Excluded

Entity for Investment Funds in keeping with the approach taken under most GAAPs that seek to exclude investment entities.

We would also raise, specifically, the issue of the Qualifying Asset Holding Company ("QAHC") regime, a regime which has been introduced following considerable work and attention from the investment fund industry, HM Treasury and HMRC. In the event that a fund structure was within the rules, but the fund fell within the definition of Excluded Entity as an Investment Fund which is an UPE, we have a specific concern that a QAHC may not always fulfil the definition of a "holding company" for the purposes of being an Excluded Entity. It is entirely possible, and indeed intended, that a QAHC may undertake activity outside its holding platform function. This may mean that it would not be regarded as operating "exclusively or almost exclusively to hold assets or invest funds for the benefit of an Excluded Entity" (see Article 1.5 of the Model Rules). We think that a QAHC should, specifically, be an Excluded Entity under UK law.

7. Do respondents have any views on the definitions of international shipping income?

No.

A.3 Chapter 5: Calculating the effective tax rate

8. Do respondents have comments on the practicalities of computing a constituent entity's accounting profit?

There are some general points in this area which we expect others responding (e.g. major accounting firms) to address. It will be critical to ensure that there is clarity on basic matters such as which accounting method should be used if a UPE prepares two sets of accounts.

9. Do respondents have comments on the adjustments made to the accounting profit? In particular, are there any uncertainties that could be clarified in the UK's domestic legislation whilst respecting the intended outcomes in the Model Rules?

Again, there are a few general points in this regard which we would anticipate being addressed in other responses (e.g. those from major accounting firms). Examples include ensuring the reference to tax consolidations in Article 3.2.8 of the Model Rules would include the UK grouping rules and addressing interaction of the rules with arm's length transactions.

It is worth noting that, as currently drafted, Article 3.2.8 could give rise to one sided GloBE Income where there is an asset transfer to or from a flow through entity to another Constituent Entity located in the same jurisdiction and that is in the same tax consolidation group, even though that flow through entity's income may be fully within the charge to tax for local purposes. This is because a flow through entity is a stateless entity for the purposes of determining its location (see Article 10.3.2(b) of the Model Rules) whilst Article 3.2.8 of the Model Rules requires the transactions to be between Constituent Entities in the same location. Consideration should be given to extending the benefit of this provision to transfers between flow through entities and entities located in the same jurisdiction as the members of the flow through entity.

10.Do respondents have views on the rules allocating profits between jurisdictions?

There may well be some issues here regarding the rules allocating income for flow through entities in certain circumstances. If an entity (A) owns a subsidiary (B) which in turn owns another subsidiary (C), with C being a Flow-through Entity then, if A considers B and C to be tax transparent A will pay tax on C's income. However, if B regards C as a reverse hybrid then, under the terms of the Model Rules, it appears that C ends up being a stateless entity with its income allocated to it with no provision to

allocate the tax paid by A on C's income back down to C. This not only risks double taxation but is not consistent with the policy of the Model Rules and therefore further consideration should be given to this.

11.What are respondents' views on the impact of the branch rules on business models involving branches taxed under the credit method?

None specific.

12.Do respondents have views on the rules on Covered Taxes and their assignment?

Although we cannot immediately see anything specific relating to investment funds, we consider that care should be taken since it can be unclear whether certain taxes and duties will be Covered Taxes or not (e.g. gaming duty, diverted profits tax).

13.Do respondents have views on how rules on timing differences work including whether there are any uncertainties around how the rules operate that could be further clarified in domestic law?

We do not think there is anything specific to funds here but we do consider there could be issues in this area which are likely to be addressed in responses from the major accounting firms.

A.4 Chapter 6: Calculating the top up tax

14.Do respondents have any comments on the special provisions for computing the ETR and top up of investment entities, joint ventures or minority owned constituent entities?

We consider it unnecessary to calculate the Top-Up Tax for Minority Owned Constituent Entities separately and are uncertain of the policy intent behind this. We also think it would desirable for this to be clear that Consolidated Financial Statements do not need to be prepared on a hypothetical basis, as seems to be suggested.

15.Do respondents have views on the process for calculating top up tax?

As with UTPR (discussed below), this seem very proscriptive and prone to distortion.

A.5 Chapter 7: Charging mechanisms

16.Do respondents have any comments on how the IIR provisions should be reflected in the UK domestic legislation while respecting the agreed outcomes in the OECD Model Rules?

No.

17.Do respondents have any views on how information or administration challenges with the split ownership rules could be addressed in the implementation framework?

No.

18.Do respondents have views on how the UTPR should be brought into charge in the UK?

No.

19.Do respondents have any other comments on the UTPR provisions in the OECD Model Rules?

These seem very proscriptive and prone to distortion. It is also unfortunate that the revised UTPR provisions in the Model Rules differ from the original Blueprint in requiring no activity between the UTPR Jurisdiction and the Low-Taxed Constituent Entity.

We note that the provisions dealing with the situation where the UPE is a Flow-through Entity require some knowledge of the tax position of the members of that entity under the Model Rules (see Article 7.1.1(a)). This will be very difficult in the context of a widely held entity and thus requires some guidance regarding how it should be addressed in practice.

A.6 Chapter 8: Transition rules

20.Do respondents have views on how rules on the transition rules work including whether there are any uncertainties around how the rules operate that could be further clarified in domestic law?

No.

A.7 Chapter 9: Reporting and payment

21.Do respondents have views on the proposed approach to reporting?

No.

22.Do respondents have views on the approach taken to collecting liabilities under the IIR or UTPR?

No.

23.Do respondents have views on the time limit for notifying the group is in scope of the Globe?

No.

24.Do respondents have views on whether payments should be made quarterly or annually for Pillar 2?

Annually would presumably be less burdensome.

25.Do respondents have views on an appropriate payment deadline for Globe liabilities?

These should coincide with other annual tax payment obligations.

26.Do respondents have views on the importance of giving credit interest for early payments?

No.

27.Do respondents have views on making UK constituent entities joint and severally liable for any (UK) Globe debts?

This would not seem to be necessary.

A.8 Chapter 10: Simplification

28.What are respondents' views on a CBCR based safe harbour and how it should be designed?

Safe harbours need to offer material simplification and any based on CbCR should follow the CbCR rules as closely as possible.

29.*How could timing differences be addressed within a CBCR safe harbour design? Do they need to be?*

No specific comments.

30.*Do respondents have views on how the rules should address when a business moves from the safe harbour into the main Pillar 2 regime?*

A safe harbour based on a domestic minimum tax could be considered.

A.9 Chapter 11: Further work in the OECD

31.Do respondents have any comments on this further implementation work?

As stated above, the administrative requirements and ongoing consultation on this are an important reason why UK legislation in this area should be delayed pending greater clarity. Interaction with GILTI is also important.

A.10 Chapter 12: Domestic minimum tax

32.Do you agree that a DMT would help to reduce compliance costs for businesses?

This may or may not be the case depending upon the detail. Overall, the concept of a DMT may seem initially attractive but we have concerns that it may, in fact, add unnecessary complexity and potentially render the UK unattractive. We think that a DMT should only be introduced after very careful consideration. This will be impossible if the current proposed timeframe for this legislation is pursued. Accordingly, we would be against a DMT at this point but would give it further thought if there was sufficient time to do so, i.e. if implementation of the Model Rules were to be delayed in the UK.

33.Do businesses agree the DMT should apply to both UK headed and foreign headed groups?

See general comment at 32 above.

34.Do businesses agree that the DMT should only apply to groups with over €750m of revenue to align with the P2 population?

See general comment at 32 above.

35.Do respondents have any comments on the policy design of the DMT?

See general comment at 32 above.

A.11 Chapter 13: Wider reforms interaction with existing BEPS measures

36.Do respondents consider there are reforms which would have a significant benefit in reducing compliance burdens without exposing the UK tax base to material risks?

No.

A.12 Chapter 14: Assessment of impacts

37.Do you have any comments on the summary of impacts?

No.