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Organisation for Economic Co-operation and Development
Centre for Tax Policy and Administration
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Submitted by email: tfde@oecd.org

RE: *Need for Robust Asset Manager Exclusion from Pillar One Amount A*

Dear Secretariat Team,

The Investment Company Institute (ICI)[1] supports strongly the Pillar One Amount A exclusion for regulated financial institutions (RFIs) that are asset managers. The test provided in the public consultation document,[2] in many cases, satisfies policy objectives and thereby ensures that profits are taxed appropriately in market jurisdictions.

Other situations exist, however, in which an asset manager does not meet the test to become an RFI despite the Pillar One policy objectives being satisfied. In these situations (*e.g.,* involving US asset managers[3] with "local market" products), the proposed definition of "Asset Manager" is too narrow. To address this inequity, the test should be modified to ensure that all revenues that arise in the manager's residence jurisdiction are excluded from Amount A under a domestic business exclusion. Alternatively, the revenue sourcing rules should be modified to allocate all revenues from asset management businesses focused on one local market to that market under a domestic sourcing rule. These alternative proposals

[1] The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia, and other jurisdictions. Its members manage total assets of $31.3 trillion in the United States, serving more than 100 million investors, and an additional $10.0 trillion in assets outside the United States. ICI has offices in Washington, DC, Brussels, London, and Hong Kong and carries out its international work through ICI Global.

[2] OECD PUBLIC CONSULTATION DOCUMENT Pillar One – Amount A: Regulated Financial Services Exclusion (6 May – 20 May 2022).

[3] The term "US asset manager," as used in this letter, includes any asset manager—whether a US parent or subsidiary or a US branch or subsidiary of a non-US parent—with respect to their activities in the United States.

(the domestic business exclusion and the domestic sourcing rule) also could be applied beyond asset management (our specific area of interest).

The revenues generated by US asset managers attributable to their US regulated investment companies (RICs), for example, should be excluded from Amount A. No policy rationale supports allocating any portion of these revenues and profits—arising from transactions with US residents—to other jurisdictions. These revenues and profits, quite simply, are generated within the United States.

The modifications that we propose would address several significant concerns. First, they would level the playing field for US asset managers, and others, that are objectively comparable to asset managers that meet the proposed test for RFI status. Second, they would prevent a financial institution with highly interconnected business units, not all of which qualify as RFIs, from incurring substantial compliance costs; these costs can be recouped only by increasing fees on the institution's customers who are saving for long-term needs and financial security. Third, they would prevent asset managers from potentially avoiding smaller markets out of concern that outsize profits would be allocated to those markets pursuant to Amount A based upon relatively insignificant market contacts.

ICI appreciates the opportunity to provide detailed comments, below, on this public consultation document. We look forward to sharing additional thoughts as comprehensive comments cannot be provided until the entire Pillar One proposal has been released.

Strong Support for the Asset Manager Exclusion from Amount A

The RFI exclusion from Amount A is appropriate as a matter of both tax policy and tax administration. Financial institutions are required by governments in the jurisdictions in which they operate to develop and maintain compliance systems and procedures to protect clients' assets.

Asset managers—because of governments' understandable demand that firms act in the best interest of fund investors—are subject to extensive regulation. Local regulation is key to ensuring that firms meet their fiduciary responsibilities to local investors. Managers of regulated funds, for example, are required to have robust policies, procedures, and systems that apply to their own operations and, as appropriate, to their significant service providers. These managers also are subject to significant governmental oversight. The highly regulated nature of these institutions ensures local substance in market jurisdictions and, therefore, that the appropriate amounts of tax are being paid there.

The asset manager exclusion is essential to effective implementation of the Regulated Financial Services (RFS) exclusion. Many financial services firms have multiple, highly interconnected, business lines. Asset managers are not monolithic; often, asset managers are only one interrelated component of firms that also provide banking and/or insurance services to both institutional and retail customers. Banks, insurance companies, and asset managers

are subject to regulations that reflect the unique characteristics of each industry. Finance-related activities often create value for multiple business units, making it difficult to properly assign specific revenues to specific lines of business. Significant administrability issues would arise if Amount A included asset management activities while other financial service activities were excluded.

The asset manager exclusion also is essential to preventing potential competitive disadvantages for those asset managers that do not have banking and/or insurance businesses eligible for the RFI exclusion. No policy rationale would exist for effectively excluding from Amount A the revenues of an asset manager that is part of a banking conglomerate, for example, while subjecting to Amount A the revenues of an asset manager that is not part of such a conglomerate.

The proposed capital adequacy requirement under the proposed asset manager test, we understand, is workable for many (non-US) asset managers such as those in the European Union.[4] This test should be applied, therefore, by those managers in determining their Amount A revenues.

Capital requirements, however, are only one aspect of this highly regulated environment and are not determinative of whether profits are allocated properly to market jurisdictions. Even when governments do not impose capital requirements, asset managers retain capital as a matter of sound business practice and to meet related obligations.

The IOSCO principles relied upon in the public consultation document for determining whether profits are properly allocated, as IOSCO acknowledges, "need to be practically implemented under the relevant legal framework to achieve the Objectives of regulation."[5] It is important to note that IOSCO's principles have three objectives: to protect investors; to ensure that markets are fair, efficient, and transparent; and to reduce systemic risk.

Some jurisdictions, based upon their own regulatory regimes, have concluded that capital requirements are necessary for asset managers. The United States achieves the three IOSCO principles for asset managers, however, without imposing specific capital requirements. The US approach to asset management—based on the regulatory scheme administered by the US Securities and Exchange Commission that reflects IOSCO's core principles for managers[6] of "collective investment vehicles" (CIVs)[7]—is viewed by many globally as the gold standard.

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[4] *See*, Investment Firms Regulation (EU 2019/2033) and Investment Firms Directive (EU 2019/2034).

[5] Objectives and Principles of Securities Regulation, INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, page 3 (May 2017).

[6] *Id.*, at page 10.

[7] The term "CIV," as provided in paragraph 22 of the Commentary on Article 1 of the OCED Model Tax Convention on Income and on Capital (November 2017 version), "is limited to funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established."

US Asset Managers Must be Excluded from Amount A

Excluding US asset managers from Amount A is essential for a level playing field. Otherwise, the Pillar One Amount A principles will apply differently to nearly identical businesses. Although this submission is focused on US asset managers and their RIC business, the rationale provided herein is applicable (in whole or in part) to other asset managers that may not meet expressly the capital adequacy requirement.

US asset managers operate in essentially the same way as those asset managers that are excluded RFIs. The regulated (CIV) products that they offer to individuals are designed to achieve the same investment objectives such as saving for retirement and other long-term needs. The CIVs' portfolios are constructed using similar investment strategies. CIVs are distributed, directly and indirectly, through regulated entities (which would qualify as RFIs) that are subject to substantive regulation (such as customer best interest and fiduciary requirements) that effectively require jurisdictional presence.

Excluding US asset managers from Amount A also is essential to preventing a manager unaffiliated with a bank or insurance company from confronting the considerable complexity of separating "exempt" and "within scope" activities across a large financial services firm. This substantial burden would be unwarranted when, as is true for US asset managers, the overwhelming majority of the revenues generated within their jurisdiction of residence are attributable to customers also resident in that jurisdiction.

Failure to provide a robust asset manager exclusion, importantly, might have a significant unintended consequence. Specifically, because an asset manager would be required to file tax returns in any jurisdiction in which it has revenue above the *de minimis* threshold, the manager would need to consider in which jurisdictions the interests in its CIVs would be distributed. If the costs of entering new markets (both compliance burdens and potential tax controversies) exceeded the benefits of new customers, it would be uneconomic to enter those markets; likewise, an asset manager might withdraw from smaller markets given these additional costs of compliance.

Notably, many of these potentially avoided markets are likely to be emerging or less developed. In these markets, savings and investment may be relatively small now but are expected to grow long-term. Potential investors in these jurisdictions may lack suitable investment opportunities if asset managers are deterred from operating there. To the extent that individuals are deprived of investment options, the result would be less saving, fewer gains, and less tax collected by governments (with the resulting burden placed on the individuals resident in those jurisdictions).

Finally, as a policy matter, it is inappropriate to treat asset manager profits as attributable to customers to the same extent as for other industries. Given that asset manager revenues typically are based upon assets under management (which fluctuate as securities trade in the

markets), residual profits are not economically attributable to market jurisdictions simply because the securities in a CIV's portfolio may appreciate significantly.

Proposal for Excluding US Asset Managers

We recommend that the asset manager test be modified to ensure that all revenues that arise in the manager's residence jurisdiction, and that would be excludable by comparable asset managers located elsewhere, are excluded from Amount A. Rather than modify the asset manager test, which works well for many non-US managers, Pillar One should be modified to provide the domestic business exclusion included in the Blueprint.[8] At a minimum, such an exclusion should be provided on an elective basis for asset managers.

US asset managers—with respect to their US business—are precisely the type of business contemplated by the previously proposed domestic business exclusion.[9] The market for RICs—CIVs regulated in the United States by the Investment Company Act of 1940—is almost entirely a US market. The tax rules applicable to RICs—such as the annual distribution requirement of essentially all of the RICs' income and gains[10] and the treatment of all dividends distributed as US source subject to US withholding tax when paid to non-residents[11]—make RICs largely unattractive to non-US investors; these individuals can invest without current tax in many non-US "roll-up" funds and in no case would incur US withholding tax on dividends that a RIC receives from non-US sources. Because RICs are so tax-inefficient for non-US investors, asset manager revenues from the RIC business are properly attributed to the United States.

To market their investment expertise outside of the United States, US-based managers create UCITS and other non-US funds that are not subject to the US RIC tax rules that make US funds unattractive to non-US investors. Because these non-US "roll-up" funds often are domiciled in countries with regulatory schemes for asset managers that include capital requirements, the revenues and profits from these non-US activities would be excluded from Amount A.

Thus, most or all of the revenues and profits of US asset managers that might be includable under Amount A are attributable to management activities in one country: the United States.

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[8] *See,* Tax Challenges Arising from Digitalising – Report on Pillar One Blueprint, page 125.

[9] Asset managers in some other jurisdictions likewise operate in "domestic-only" markets.

[10] To qualify for the tax treatment provided to regulated investment companies by Subchapter M of the Internal Revenue Code, sections 851 *et seq.,* a RIC must distribute with respect to its taxable year at least 90 percent of its ordinary income (including net gain on assets held for one year or less). 26 U.S.C. § 852(a)(1)(A). In addition, a RIC must distribute by December 31 an amount equal to the sum of 98 percent of its ordinary income for the entire calendar year, 98.2 percent of its capital gain net income for the twelve-month period ending on October 31, and any amounts not distributed in the prior calendar year to avoid a 4 percent excise tax on the difference between the required distribution and the amount actually distributed. 26 U.S.C. § 4982.

[11] The US withholding tax on dividends is imposed at a rate of 30 percent, although that rate often is reduced by income tax treaty to 15 percent. 26 U.S.C. §§ 871, 1441.

Allocating asset manager profits from the distinct US market to other jurisdictions is inconsistent with the goals of Pillar One.

Alternatively, should a domestic business exclusion not be provided, the revenue sourcing rules should be modified to allocate all revenues from an asset management business focused on one local market to that market. While such a domestic sourcing approach would not exclude this revenue from Amount A, it would ensure that the revenue would be taxed only in the jurisdiction in which the CIV shares are marketed and the revenue is earned. For a US asset manager, this would mean that all revenues generated by the manager's RIC business would be taxable only in the United States.

Additional Modifications to the Test for Excluding Revenue from Amount A

Additional modifications are necessary for Amount A to apply properly to asset managers. First, the covered activities in the gross income part of the "Asset Manager" definition (paragraph c) should be expanded. Although the proposed test ("administering, managing or distributing interests" in an Investment Fund) appears intended to be all-encompassing, this part of the test, or the Commentary, should reference all activities related to the management of the Investment Fund's securities portfolio, the operation of the Investment Fund itself, the distribution of the Investment Fund's shares, and ancillary activities (such as investment advice, risk management, trading and operations, and reporting) benefiting the asset manager's clients.

Second, all profits from client monies managed by a covered subsidiary or branch (such as a UK affiliate) of an asset manager should be attributed to that location (and excluded as appropriate from Amount A) regardless of whether the client came directly to the covered subsidiary or branch or was referred, for services, from a non-covered subsidiary or branch.

Third, depending on the extent to which our other proposals are adopted, additional sourcing guidance may be required. Because CIV shares, as noted by OECD in the 2010 CIV Report,[12] are distributed through highly intermediated business arrangements, an investor's residence cannot always be determined precisely. Allocating an asset manager's profits based upon GDP or population could reward jurisdictions with few investors and reduce tax paid in the asset manager's home jurisdiction.

Our Proposals Are Designed to Prevent Significant and Expensive Tax Controversies

Significant tax controversies can be expected if the modifications we propose are not adopted because the asset management business involves very complex arrangements. We are extremely concerned about the possibility that specially created bespoke financials, that would be necessary for any portion of the asset management business not excluded from

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[12] This Report, adopted by the OECD Committee on Fiscal Affairs on 23 April 2010, is entitled "The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles."

Amount A, would be subject to review and challenge by the many jurisdictions (possibly over 100) in which an asset manager operates. Allocating revenue and profits from customers of multiple (included and excluded) business lines would require substantial information management improvements that would be expensive and also subject to challenge. Tax authorities also may question the appropriate residences of customers in highly intermediated structures.

All of these challenges, which would be costly to address, are avoided with a robust asset manager exclusion from Pillar One Amount A. Strong tax policy and administrative reasons, as explained above, support the proposals we make in this submission.

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The ICI strongly supports a robust asset manager exclusion from Amount A and urges that it be modified, as appropriate, to ensure that revenues and profits attributable to asset management activity arising in only one jurisdiction are excluded from Amount A (under a domestic business exclusion) or sourced only to that jurisdiction (under a domestic source rule).

We would be pleased to respond to any questions you have regarding this submission. Please feel free to contact the undersigned, at lawson@ici.org or 1-202-326-5832, at your convenience.

With kind regards,

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