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BVCA response to the OECD consultation – Pillar One Blueprints

The British Private Equity and Venture Capital Association ("BVCA") welcomes the OECD's efforts to develop a consensus solution to the tax challenges arising from the digitalisation of the economy and are pleased to have the opportunity to comment on its public consultation document, 'Reports on the Pillar One and Pillar Two Blueprints' (the "Condoc") and, specifically in relation to the Report on Pillar One Blueprint (the "Pillar One Blueprint"). We write under separate cover in relation to our comments on the Report on Pillar Two Blueprint.

The BVCA is the industry body for the private equity and venture capital industry in the UK. With a membership of over 700 firms, the BVCA represents the vast majority of all UK based PE/VC firms, as well as their professional investors and advisers. BVCA members invested over £43bn into nearly 3,230 UK businesses in the period 2015-19, the majority being SMEs, and companies backed by PE/VC currently employ around 972,000 people in the UK.

What differentiates private equity and venture capital funds (PE/VC funds) from many other sources of financing is the active involvement of the manager in advising on the running of the businesses invested in, strengthening management expertise, delivering operational improvements and/or helping companies to expand into new markets. This active approach is also employed in helping underperforming companies to survive, protecting jobs and delivering successful businesses with a strong future.

A significant proportion of private equity and venture capital funding comes from pension funds and insurance companies who invest the pensions or savings of millions of citizens across the world. Private equity and venture capital is a key asset class for these long-term investors, as it generates capital gains on a consistent basis over the long-term. This is important, not least against the backdrop of changing demographics and in today's low yield environment.

Summary of Key Concerns

As we explained in our prior submission, the apparatus of a PE/VC investment fund generally consists of four key components – the fund, the investee businesses (referred to as portfolio companies), the investors and the fund manager. Where these portfolio companies are themselves consumer facing businesses they will be subject to the proposed new Pillar One regime in the same way as other MNEs. This is accepted and we certainly welcome the OECD's efforts to bring uniformity to the approach taken to digitalisation in this respect.

However, the characteristics of the PE/VC fund holding these MNEs together with its fund manager are such that very careful crafting of the rules, in particular the proposed financial services carve out, will be key to ensure that the industry is not inappropriately brought within scope of the regime.

We have considered the Pillar One Blueprint carefully and are satisfied that significant progress has been made in this regard, in particular in relation to how (and why) a financial services carve out is envisaged and as to how this would apply to funds. However, we have outlined below some residual concerns and observations that we have in this respect.

1. Scope – The Fund Vehicle

The fund itself is a collective investment vehicle, with investors receiving interests in, rather than goods or services from, the fund. By their nature, the investors in funds are not consumers. The role of these investors is more akin to a passive shareholder in a company rather than a consumer of services. As the fund has no consumers, it is not an enterprise within the scope of the rules. We welcome the comments in paragraph 136 of the Pillar One Blueprint which conclude that funds themselves are considered to be outside the scope of CFB for this reason.

This position should be put beyond doubt by ensuring that the fund vehicle arrangements are themselves specifically excluded from the scope of the rules.

A specific exclusion from these rules for a targeted and defined category of investment fund arrangements would provide certainty in this area and significantly reduce advisory and compliance costs for funds. Given the careful and detailed work the OECD has already carried out in developing an appropriate and tightly drawn definition of an 'investment fund' in relation to Pillar Two, we believe that this same definition should also be used for Pillar One purposes. This will be the most effective way to achieve a robust, coordinated and coherent regime as regards the application of these rules to investment funds (as well as to arrangements that do not qualify as such). It would also have benefits as regards consistency and ease of implementation across Member States.

Whilst there may be arguments that a broader definition of Investment fund could be used for Pillar One purposes, in particular as regards single investor fund structures, we can see no compelling reason why the treatment of investment funds for the Pillar One proposal should be narrower than that used for the purposes of the Pillar Two proposal. Any such approach would in our view increase complexity and cost whilst reducing the certainty as to the scope of both regimes.

2. Scope - Fund management

We would like to reiterate that we welcome the approach that it is suggested will be proposed in respect of investment fund vehicles themselves (as discussed above) and, naturally, we also fully support the overall conclusion in paragraph 140 of the Pillar One Blueprint that the activities of investment managers do, and should, fall outside the scope of CFB. We acknowledge and are appreciative of the engagement the OECD has shown as regards prior representations made on this topic.

However, given some of the comments in the Pillar One Blueprint in relation to investment management services, it is clear that some key topics in this area are still being actively debated and as such we remain concerned that these may be subject to further changes. Our view remains that the rationale for an exclusion covering fund entities themselves applies equally to the business activities of the fund managers that provide services to those very vehicles. We believe it is important for this to be clarified from the outset in order to avoid inconsistent interpretation or application of the key principles by different jurisdictions down the line.

As such, it is critical that any financial services carve out covers this area, so that fund management activity also falls outside of the scope of Amount A, as explained below.

We note the observations in paragraph 124 of the Pillar One Blueprint that: "With regard to CFB, very significant parts of FS business are not consumer-facing. However, there are also significant parts of the FS business that involve CFB." We would submit that management of Investment Funds is *not* one of those areas of FS business that involve CFB, on the basis that investors in investment funds are not acting as 'consumers' in respect of their investment in a fund (as set out above). Some of the commentary in paragraphs 137 to 140 of the Pillar One Blueprint appears to accept the premise that 'consumers' are recipients of such services, or that they could be in the absence of a financial intermediary, or that the funds themselves are making the services relationship indirect (as per paragraphs 138 and 139 of the Pillar One Blueprint). In our view it is important to retain a clear distinction between the activities carried out by fund managers as regards investors in funds and some of the consumer facing services that may be provided by financial intermediaries to their customers.

It appears from the Pillar One Blueprint that a key part of the rationale for excluding investment managers from the Amount A rules focuses on practical considerations regarding access to information about consumers (e.g. on the premise that the percentages of retail investors (consumers) and other professional and institutional investors are "in a state of constant flux"). Whilst we do not disagree with the sentiment of these comments per se, we believe the emphasis on the practicalities and regulation leaves scope for future misapprehension of the position as regards private equity and venture capital funds. Our view is that, in fact, the overriding reason for private equity and venture capital fund management services being excluded from scope is simply that this is not an industry in which services are received, even indirectly, by "consumers" in the first place. This is for the following reasons:

- We note that "Consumer" means an individual (whether or not the direct purchaser) who acquires a good or service for personal purposes, rather than for commercial or professional purposes (as described in paragraph 33 and Box 2.32 of the Pillar One Blueprint).
- As a general matter, fund management services are provided to private equity and venture capital funds (or their general or managing partners, which are business entities). Therefore the customer/recipient of such services is not a "consumer", rather it is a business (and a business which would itself be exempt from Amount A as discussed in section 1 above). We see no reason why that exemption should not extend to the provision of services to a vehicle which is itself exempt.
- Even if one 'looks through' the investment fund arrangements to the indirect 'purchaser' of such services, we note that PE/VC funds are simply pooling vehicles to facilitate collective investment by a largely institutional investor base. Participants in funds (of any nature) are in any event investors and should not be considered consumers. A participant in a PE/VC fund will contribute capital in return for an interest in the fund, which will then use that capital to make investments. A participant will then be entitled to their share of the profits (if any) of the investments made by the fund. This business model is entirely different from the "consumer-facing" businesses targeted by the Pillar One proposals.
- Also importantly, in any event the significant majority of investment made by investors in PE/VC funds is by institutions (predominantly pension funds, insurance companies and sovereign wealth funds). These are not consumers - they are neither individuals nor are they acquiring their interests for personal purposes. Indeed, in 2018 only 2.6% of investment in private equity and venture capital in the UK came from private individuals.
- In circumstances where an alternative investment fund does admit individual investors, these will typically be highly sophisticated and invest in a professional or quasi-professional manner (in line with regulation governing the marketing of these funds), and so are not

"retail" investors[1]. Such investors will ordinarily agree to invest in funds only after careful due diligence and following arm's length, business-to-business discussions/negotiations with the manager or promoter of the fund and so should not be considered "consumers" in this context for the same reasons explained above.

Recommendations

In summary, we recommend that:

1. The proposed financial services carve out should specifically cover the investment managers that service investment fund arrangements.

2. The definition of the term "consumer" should make it clear that it does not include investment funds or investors in investment funds.

3. Fund vehicle arrangements are themselves specifically excluded from the scope of the rules by adopting the same definition of an excluded 'investment fund' as is proposed in relation to Pillar Two.

We would also very much welcome continued engagement with the process of refining and legislating in respect of the proposed exemptions and financial services carve out, in order to ensure that our stakeholders' particular positions can be appropriately taken into consideration.

We would very much welcome the opportunity to discuss our response in more detail and would be happy to walk through any of the characteristics of our industry that we have outlined in this letter. Please contact Chris Elphick for further information.

Yours faithfully,

Mark Baldwin
Chairman of the BVCA Tax Committee

[1] In 2018 in the UK, pension funds provided 39% of all capital raised followed by fund of funds (13%), sovereign wealth funds (10%), and insurance companies (10%). As stated previously private individuals make up only a small amount (2.6%). Please see our Report on investment Activity 2018 for further information.