

2 December 2019

## **INREV response to Global Anti-Base Erosion Proposal (GloBE) – Pillar Two**

INREV welcomes the opportunity to comment on the recent OECD Public consultation document Global Anti-Base Erosion Proposal (“GloBE”) – Pillar Two (the “Public Consultation Document”).

We are very pleased that the OECD seeks the view of the stakeholders in the investment management industry in order to find appropriate solutions for the development of a coordinated set of rules to address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation.

### **Comments**

In paragraph 1 and 7 of the Introduction of the Public Consultation Document, the general aim of the GlobalBE proposal under Pillar Two is stated:

“address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation .... by ensuring that the profits of internationally operating businesses are subject to a minimum rate of tax.”

In addition to various suggested ways to impose a minimum tax on MNEs Section 4 the Public Consultation Document calls for the exploration of specific carve-outs, amongst others for returns on tangible assets.

In this document INREV will address the concerns raised by the Public Consultation Document for our sector and propose a Pillar Two carve-out for “non-CIV” real estate funds.

INREV believes that the concerns raised in relation to Pillar Two do not apply to non-CIV real estate funds due to the specific tax treatment of real estate investments under the tax laws of the source state, which is supported by article 6 of the OECD Model Tax Convention on Income and Capital (Model Treaty). Therefore, and as further elaborated below, INREV believes that a specific carve-out for non-CIV real estate funds is justified, whether on a standalone basis or as a part of a more general carve out of non-CIV funds or a broader sector. This carve out could be on the basis that Real Estate non-CIVs are not MNEs in the traditional sense, or on the basis that their purpose is to flow returns that have already been fully subject to tax in source states, to investors in multiple jurisdictions.

### **No remaining BEPS challenges in the case of non-CIV real estate funds**

INREV would like to emphasise the purpose and the unique tax position of non-CIVs investing in real estate (“Real Estate Non-CIVs”).

As explained further below, Real Estate Non-CIVs are not used to shift profit to jurisdictions where they are subject to no or very low taxation.

The primary commercial purpose of Real Estate Non-CIVs is to enable collective investment in real estate assets for the account of multiple investors. As we have stated in previous submissions<sup>1</sup>, we believe that BEPS Action 6 should put investors in Real Estate Non-CIVs in the same tax position that they would be in if they had invested in the underlying real estate assets directly. We emphasise that this goal is in line with the policy defined by the OECD in the 2010 CIV report. In other words, there should be tax neutrality between a direct investment in real estate and an investment in real estate via a non-listed real estate vehicle including a Real Estate Non-CIV.

Income derived from a direct investment in real estate is generally taxed at the level of the investor owning the real estate asset through imposition of (corporate) income tax in the source state. To avoid double taxation, the investor's home state exempts this income earned on real estate in another state from (corporate) income tax in accordance with article 6 of the Model Treaty. In contrast to income from other asset classes, the Model Treaty does not restrict source states in their right to levy tax on real estate income – see also section 6 and section 13(4) of the Model Treaty.

Pooling real estate investments through a Real Estate Non-CIV does not limit the right of the source state to levy (corporate) income tax. The only consequence of interposing a Real Estate Non-CIV is that the source state exercises its taxing right at the level of the Real Estate Non-CIV (or a subsidiary of such Real Estate Non-CIV), rather than at the level of the investor. As the Real Estate non-CIV will frequently be exempt from tax, either on the basis of a treaty exemption (for direct investment in real estate, although this is rare for risk reasons), or based on a domestic law exemption, which is often the case for the same policy reasons that apply for CIVs and non CIVs, we would have a concern that the Pillar Two provisions would apply to payments made to the Real Estate Non-CIV. Investors in Real Estate Non-CIVs will generally be taxed on the distributions or on a transparent basis, although depending on the investor, the distributions may be exempt from further residence state taxation particularly in the case of Pension Funds, which are major investors in Real Estate Non-CIVs in the current market

For a number of commercial and legal reasons, a real estate non-CIV fund generally holds its real estate investments through one or more (controlled) special purpose companies (SPCs). These reasons include the protection of the real estate fund from the liabilities of and potential claims against the fund's immovable property assets as well as facilitating debt financing, including debt by third-party lenders.

The primary role of these SPCs is generally to ensure isolation of the liabilities of and potential legal claims against each asset or relatively small group of assets. Especially real estate investments that

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<sup>1</sup> INREV response to OECD Discussion Draft “BEPS Action 6: preventing the granting of treaty benefits in inappropriate circumstances”, dated 14 March 2014; INREV response to OECD Public Discussion Draft “Follow Up Work on BEPS Action 6: Preventing Treaty Abuse”, dated 21 November 2014; INREV response to OECD “Revised Discussion Draft BEPS Action 6: Prevent Treaty Abuse”, 22 May 2015; INREV’s response to OECD’s “Public Discussion Draft: Treaty Entitlement of Non-CIV Funds”, dated 24 March 2016; and INREV’s response to OECD’s “Public Discussion Draft on non-CIV examples” dated 1 February 2017.

are financed with external debt need to be ring-fenced because of the potential liabilities relating to the external financing arrangements.

To secure the tax neutrality of Real Estate Non-CIVs compared to a direct investment, it is important that the interposition of such SPCs does not cause an additional tax burden that would not arise if the investments were held directly.

One of the main concerns underpinning Pillar Two is the risk of MNE's that shift profit to low or no tax jurisdictions. As noted above, income derived from real estate assets owned by a Real Estate Non-CIVs is, per definition subject to full taxation while the Real Estate Non-CIV provides for tax neutral distribution to its investors a result which is in line with policy defined by the OECD and should not therefore fall under the scope of Pillar Two.

## **Conclusion**

INREV believes that shifting profit to jurisdictions subject to no or very low taxation is not the purpose of a Real Estate Non-CIV, given the unique tax profile of real estate as described above. Further, INREV believes that exposing Real Estate Non-CIV to additional minimal taxation is in breach with the concept of tax neutrality of Real Estate Non-CIVs and therefore are Real Estate Non-CIVs and their SPCs should be carved out of Pillar Two as a measure mentioned in paragraph 74 of Section 4.

## **About INREV**

INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. Since its launch in 2003, it has grown to almost 475 members from more than 32 different countries. INREV's aim is to improve the accessibility of non-listed real estate funds for institutional investors by promoting greater transparency, professionalism and standards of best practice. INREV is led by institutional investors and supported by other market participants such as fund managers, investment banks, academics, lawyers and other advisors. As a Pan-European body, INREV represents a unique platform for sharing knowledge of the non-listed real estate investment industry.