Tax and facilitating investment into carbon abatement projects: Discussion paper in the light of COP26

Executive Summary

This paper is intended to contribute to discussions leading up to and following COP26[1] on how to facilitate capital flows into decarbonization projects – especially in developing countries. It focuses on the role of tax policy and the possibility of increasing certainty and tax neutrality in investment structures. The purpose of the paper is not to question the existing international tax architecture but to look at the possibility for a special decarbonization regime.

There are already various globally recognized tax regimes which are designed to facilitate investment into certain sectors – for example Real Estate Investment Trust (REIT) rules[2]. This paper raises the concept of a Qualifying Carbon Abatement Regime. This would enable investors – potentially restricted to certain types of investment fund vehicles – to invest (directly or indirectly) in a Qualifying Carbon Abatement Entity. The regime would be designed so that tax would be paid under the normal corporation tax rules at the level of the investee entity, and at the ultimate investor level according to the rules of the country of residence of those investors. However, it would be designed to help remove, or reduce, tax on any investment flows between the investee entity and the investors –facilitating cross-border investment into decarbonization projects.

The paper raises a number of questions about how such a regime could be achieved. These have been discussed at a roundtable with a group of international institutions and investors on 24 September 2021[3] and with a group of members of the Global Infrastructure Investment Association (GIIA) on 5 October. A summary of the discussions is contained in the comment box after each section.

Introduction

The International Energy Agency (IEA) Report (May 2021) [Net Zero by 2050 - A Roadmap for the Global Energy Sector)] estimates that in order to reach net zero carbon emissions by 2050 it is necessary for investment into the clean energy sector alone to increase to US$4 trillion annually by 2030. There are multiple barriers to achieving such investment especially in developing countries, where the pace of investment "needs to increase by more than seven times – from less than US$150 billion last year to over US$1 trillion by 2030 to put the world on track to reach net-zero emissions by 2050"[4].

A new IEA report, Financing Clean Energy Transitions in Emerging and Developing Economies[5] states there is "no shortage of capital globally to realize such a vision. However, this capital is not finding its way to the countries and sectors where it is most needed. Many institutions are supporting energy transitions in developing countries, with good intentions and often impressive results. *But private capital does not yet see the right balance of risk and reward in clean energy projects* [emphasis added]".

These risks include technology risk, uncertainty about future income streams, the length of time projects take to become viable as well as issues such as political and currency risk and uncertainty about land ownership and legal aspects.

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[1] Conference of the Parties 26, the UN Framework Convention on Climate Change conference to be held in Glasgow in November 2021

[2] REIT regimes take different forms depending on local law but the term is commonly used to describe real estate investment entities that qualify for concessional tax treatment if certain requirements are met, such as widely held requirements, limited (targeted) types of investments and/or distribution thresholds. For example, the U.S. REIT regime is well known globally and contains specific qualifying requirements set out in section 856 of the U.S. Internal Revenue Code and related provisions.

[3] Tom Roth - International Finance Corporation, Chiara Bronchi - Trade and Investment Practice of the World Bank Group, Richard Goulder - InfraRed Capital Partners, Richard Johnston - Wren House Infrastructure Management, Neil Marcovitz - Tax for BCI, Patricia Brown - UN Inter-Regional Advisor on Tax Matters, Erik Banner-Voigt - Copenhagen Infrastructure Partners, David Linke, Chris Morgan, Mike Hayes & Loek Helderman – KPMG and Neil Lawson & Becky Holloway – Jericho Chambers

[4] It's time to make clean energy investment in emerging and developing economies a top global priority - News - IEA

[5] Financing Clean Energy Transitions in Emerging and Developing Economies 21 June 2021)

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A further issue is tax. Tax will not be the key factor in deciding on whether or not to make an investment, but it may influence location and whether or not a marginal project is viable. Investors also often cite uncertainty about future changes as the major tax risk[6].

According to the above-mentioned IEA report, Financing Clean Energy Transitions in Emerging and Developing Economies: "The shift towards a more capital-intensive energy system means that keeping financing costs low will be critical to accelerating energy transitions while keeping them affordable. However, for the moment, capital is significantly more expensive in emerging and developing economies than in advanced economies."

Tax policy can create incentives which reduce the cost of capital and encourage investment or can create uncertainty and increase the cost of capital so acting as a barrier to investment.

Tax incentives for carbon abatement projects could include repayable research and development credits, investment allowances, and transfers of tax losses. In some ways these are akin to direct government subsidies - to reduce the cost of investment. They are not the focus of this paper.

The purpose of this paper is to explore potential tax barriers to investment, specifically:

- non-deductibility of financing costs in determining taxes on profits
- taxes on distributions of interest or dividends
- taxes on direct or indirect gains from the sale of assets

However, while such taxes represent a cost to be priced in from an investor perspective, such investors understand they are a vital source of revenue for governments. Therefore, there is a balance required between, on the one hand, removing obstacles which can prevent or reduce investment flows and, on the other, helping to ensure governments can collect tax and structures cannot be used for avoidance purposes. If the correct balance can be achieved, removing tax barriers should increase investment and therefore both support climate objectives and generate incremental tax revenues in the investee country (including through corporate taxes, employment taxes and sales taxes).

Qualifying Carbon Abatement Regime

This paper discusses the possibility of using a recognized "Qualifying Carbon Abatement Regime" (QCAR) to address certain tax issues.

A QCAR could be implemented in any region or country however, it is acknowledged that it is often developing countries where such tax barriers and other economic challenges exist and where clean energy investment is needed most.

A QCAR should not be designed to reduce the tax take in the home country. By contrast, if intermediate tax barriers are reduced via the adoption of a stable, internationally recognized regime, investment could be expected to increase in the participating countries which would increase local corporate tax take once the projects become profitable and generate other taxes, such as employment taxes, immediately.

A QCAR could potentially involve two types of vehicles. The first would be a Qualifying Carbon Abatement Entity (QCAE) which would be a company formed for the purpose of undertaking one or more Qualifying Carbon Abatement Projects (QCAP). The second would be a Qualifying Carbon Abatement Intermediary (QCAI) which would be an entity created for the sole purpose of holding, managing and financing investments in QCAEs.

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[6] Going green: Recovery through the lens of an asset manager - The Global Responsible Tax Project (kpmg.com); Going green: An institutional investors take on a green recovery - The Global Responsible Tax Project (kpmg.com)

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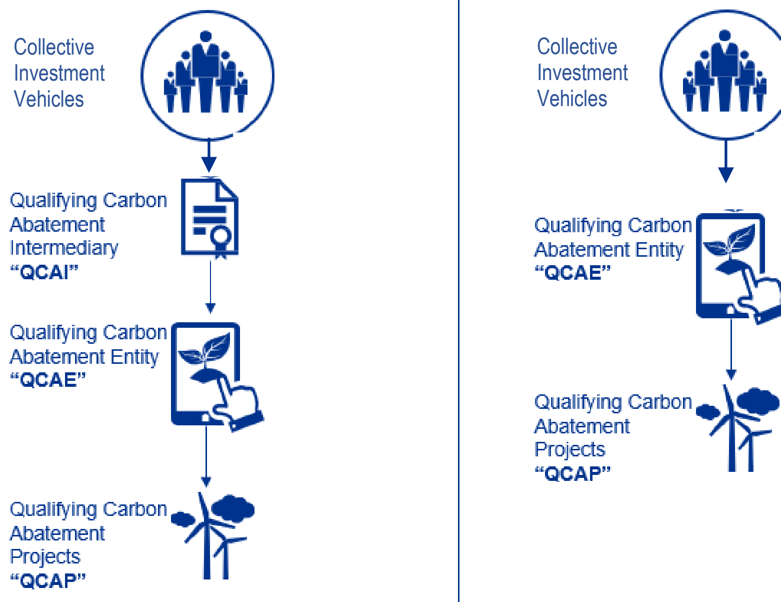

In principle there is no reason why the QCAP needs to be in same jurisdiction as the QCAE – which would allow one company to operate multiple projects via branches in different countries.

The regime is aimed at mobilizing large scale investment of capital, for example, through investment, pension and sovereign wealth funds or insurance companies. It is likely that the QCAI is owned by a number of different shareholders although potentially it could have just one fund owning 100%.

Comments	
Question posed to participants:	*Does it make sense to look at this type of regime to facilitate cross-border investment?*
Summary of responses	During the roundtable it was noted that in a post COVID-19 world only a small number of countries were able to increase spending on green projects and these countries were ones which were already on the path to do so. For countries to make progress in securing green investments from both public and private investment, the enabling environment is extremely important. From an investor perspective, where the QCAR may be of particular use is to provide tax regime stability and certainty for green investments into developing countries, which is comparable with the certainty most collective investment schemes operating through traditionally stable regimes can expect. It was pointed out that any regime which involved giving up certain taxing rights (such as withholding taxes) in order to encourage greater investment needed to be evaluated on a country-by-country basis – e.g. to what extent was the country reliant on inward investment and how could the potential for increased investment be calculated. However, the regime should be particularly attractive to countries which have traditionally used bespoke deals to attract infrastructure investment. It could provide a more level playing field which is not only transparent but has been rigorously tested to help ensure it brings more advantages than costs. One participant noted that one of main risks with such projects was currency risk – even if it was profitable over time in local currency there could be an over all loss taking account of currency fluctuations.

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Comments	
Question posed to participants:	*Should any QCAR require the ultimate investors to be diversified (e.g., through some kind of fund) or could it apply where the investment is made by a single multinational enterprise (MNE) carrying on a trade?*
Summary of responses	There was some recognition that including MNEs in the regime may create an adverse public perception as it could be seen as some kind of tax break. Also, an MNE might invest in the project anyway without any regime, while an institutional investor's or wealth fund's capital is both more long-term and mobile, tied to returns rather than market coverage, and is therefore more likely to be invested in a country with a more stable and certain tax regime. Nevertheless, it was pointed out that the QCAR regime is not a cost-based tax incentive so it does not change how much corporation tax is paid on profits at the QCAP level, rather its main aim is to improve certainty on how much of that profit will flow upwards through the chain, which should be no different between institutional investors and MNEs. If the aim of the regime is tax neutrality it could be discriminatory not to apply it to MNEs, especially given that there will be a necessary collaboration/joint venturing between MNEs (providing technical expertise) and institutional investors (providing capital) in development stage decarbonization projects, so they will collectively face many of the same risks when investing in developing countries for climate change mitigation purposes. It was noted that a fund may invest directly in an MNE and capital from a private individual could be invested directly in an MNE or via a fund – so was it logical to exclude one investment path? From a pure policy perspective, it may be better to include MNEs but from a political/optical perspective it may be better to exclude them. Furthermore, there would be a practical reason for excluding MNEs if the regime would require any carve out from Pillar 2 (global minimum tax) of the OECD Inclusive Framework proposals as this could be more easily achieved if aligned with the existing proposed carve out for institutional investors.

Conditions

To qualify as QCAP/QCAE certain conditions would have been met. For example:

- Certification of activity by a recognized international body or bodies,
- Satisfy certain objective criteria - such as on a green taxonomy or resulting in an abatement of a certain amount of CO2 in comparison with a benchmark,
- All, or substantially all, of the activity would have to satisfy the carbon abatement criteria,
- Comply with audit and transparency standards.

Live example

With regards to criteria, Luxembourg already (as of 2021) gives favourable tax rates to funds for investments in sustainable assets.[7] The fund must show that they have a portion of their net assets invested in "taxonomy" compliant activities within the meaning of article 3 of EU regulation 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment.[8]

[7] https://home.kpmg/lu/en/home/insights/2021/02/reduced-rate-of-subscription-tax-for-investments-in-sustainable-assets.html

[8] REGULATION (EU) 2020/852 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32020R0852

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This regime includes six environmental objectives which a project could cover:

i. climate change mitigation;
ii. climate change adaptation;
iii. the sustainable use and protection of water and marine resources;
iv. the transition to a circular economy;
v. pollution prevention and control; and
vi. the protection and restoration of biodiversity and ecosystems.

Whether or not these criteria would be suitable for use by the QCAR would depend upon the scope of any envisaged regime.

Tax considerations

Overall tax architecture

The main purpose of a QCAR would be to remove tax barriers to cross border investment. Corporation tax would be paid at QCAP level under normal local tax rules and the ultimate investors would be taxed according to their rules in their country of residence. However, the regime would remove any extra tax on investment flows between the investors and the QCAP.

Comments	
Question posed to participants:	*Should the architecture of the QCAR be based on the premise that:* *a) tax should be paid locally on the profits generated and* *b) at the investor level under the rules applicable in their jurisdiction of residence but* *c) there should be no other tax charges within the investment holding and funding structure*
Summary of responses	There was agreement in principle on these points amongst participants. Others noted that there does not even need to be no other charges within the investment structure, rather these just need to be agreed upfront and clear in their operation.

Corporation taxes at the QCAE/QCAP level

Taxes paid at the local level generate revenue which is critical for governments, especially in developing countries where corporation tax makes up a larger percentage of the tax revenues than in developed countries. If the tax is charged upon the profits of the QCAE/QCAP (as opposed to revenues) this should not change the profile of the return to investors (i.e. will not change a small profit into a small loss).

However, it could be argued that a lower tax rate could encourage investors to invest in risky projects, but this could ultimately deprive countries of tax revenue. Another option could be to exempt profits (or apply a lower rate) up until the point where the investor has recovered their investment; at this stage a higher rate of tax would apply. In this way the local government would be investing in the project and taking some of the risk but with a greater potential return[9].

Nevertheless, there is considerable global debate about the efficiency of this sort of incentive[10] and it would have to be carefully managed and monitored. Additionally, it is unclear at present whether any benefit obtained by a low corporate tax rate would be unwound under any global minimum tax agreement under Pillar Two of BEPS 2.0.

[9] This split rate approach is applied for example to royalties paid under Canada's oil sands regime and to certain mining royalty regimes such as in British Columbia.
[10] See for example: Is there a place for tax incentives in post-COVID Africa? | ONE

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Due to the nature of many projects which would be undertaken by a QCAP, for example, building renewable energy infrastructure, they are likely to make losses in the early stages then transition to being profitable for the long life of the asset. Instead of implementing separate taxation regimes for these phases, a QCAR could instead provide carried forward loss relief rules, allowing investors to offset losses against future profits. Issues to be decided include the rate of tax depreciation on capital assets and whether there would be any restriction on the amount of carry forward losses which could be utilized in any year.

The different risk appetites of investors often mean that divestment / investment in such projects can happen when the risk and return profile changes, which is likely to be before all losses in the above scenario are utilized. It may be necessary to help ensure that this change in ownership does not result in the forfeiture of these tax attributes except in obvious abuse scenarios.

Comments	
Question posed to participants:	*Notwithstanding the basic principle that tax should be paid under normal rules at the QCAP and investor level, are there sound policy reasons for introducing special rules or rates at the QCAE/QCAP level in order to facilitate investment that would otherwise not be made?*
Summary of responses	It was also noted that often special tax rules can be difficult to administer and make a regime needlessly complex. Other participants noted that if the project is viable and there are local investors willing to invest, then tax measures to attract foreign investors are unnecessary. The general consensus was that any QCAR should be kept simple and not have special incentives within it; however, it would be up to each country on a case by case basis to decide if extra measures were necessary and efficient to attract investment.

Corporate tax at the QCAI level

If tax is levied on the profits of the QCAE and on the end investors any additional taxes in the system could be seen as tax leakage. It is important to consider corporate taxes at the QCAI level.

Traditionally investors have used nil tax jurisdictions or regimes to host asset holding companies or investment pooling vehicles to help minimize tax leakage throughout the structure. However, the use of these regimes has been under pressure in recent years – whether from the EU Blacklist, the potential impact of Pillar Two and a minimum global tax standard, or negative public perception.

To the extent that a QCAI only receives dividend income which is not taxed in the location of the QCAI due to a participation exemption this should not be an issue as exemption of foreign dividends, is a fairly established practice. However, there may be cases where the QCAI receives net interest income or (less likely) royalties. This poses a dilemma. On the one hand a QCAR should not create a tax charge at the QCAI level – if the intention is to prevent tax leakage and only apply tax at the operational and investor level. On the other hand, the regime should not allow for tax avoidance.

It is possible that this dilemma can be resolved at the level of the Pillar 2 design. There is ongoing discussion about how to make sure minimum tax rules would not unintentionally expose collective investment entities to minimum tax. Therefore, the rules could potentially operate so that interest (or royalties) paid to a tax exempt QCAI which was held by qualifying investment vehicles would not be subject to the income inclusion rule. However, Pillar Two rule definitions of Excluded Entities[11], while useful, still do not fully cater definitionally for the all type of investment structure – for example the Pillar Two Blueprint[12]

[11] The Ultimate Parent Entities that qualify as Excluded Entities are investment funds, pension funds, governmental entities (including sovereign wealth funds), and international and non-profit organizations. An investment fund for this purpose means an entity or arrangement that meets several criteria, including: (a) it is designed to pool assets from an Excluded Entity or a number of investors (at least some of which are not connected); (b) it invests in accordance with a defined investment policy and/or to reduce transaction costs and research and analytical costs and/or to spread risk collectively; (c) the fund, or the management of the fund, is subject to the regulatory regime for investment funds in the jurisdiction in which it is established or managed (including appropriate anti-money laundering and investor protection regulation); and (d) it is managed by fund management professionals on behalf of the investors. An investment fund also includes an entity that is wholly owned or almost exclusively owned by one or more investment funds or other Excluded Entities, that does not carry on a trade or business, and that is established almost exclusively to hold assets or invest funds for the investment fund or Excluded Entities.
[12] https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint.pdf

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released in October 2020 would not exclude an asset holding company which was partly owned by an insurance company as opposed to being almost exclusively owned by investment and pension funds. It would be necessary to help ensure that however the 'owner-base' of a QCAE is defined, the QCAI is afforded 'good status' under Pillar 2 or equivalent rules so the Pillar Two rules would not apply to it.

Comments	
Question posed to participants:	*To remove "tax leakage" in the structure, is it sufficient that the QCAI can exempt dividends from the QCAE or is it necessary that interest and royalties should also be exempt and not subject to a minimum global tax rule under Pillar Two?*
Summary of responses	Participants agreed, almost unanimously, that trying to exempt interest returns from corporate tax (as opposed to withholding tax – see below) at the QCAI level would be undesirable for a number of reasons. Although it was noted that often capital investment includes debt, focusing the regime on equity capital is key. Having a structure which could create a hybrid mismatch or convert an interest distribution into capital seems untenable. One participant noted that where debt financing is used it is usually possible to structure it so there are not (significant) multiple layers of tax. Another participant noted that this would be a new regime, and the farther away this regime is from international tax norms, i.e. the more novel it looks, the less likely it is to be used. Also, trying to carve out interest could result in challenges from authorities and undermine the whole regime. Thinking specifically on how this would interact with Pillar 2, participants thought that, if there would have to be a carve out, it would mean the QCAR would have to be restricted to investment funds and not extended to MNEs.

Restriction on debt funding

As discussed, many QCAP projects are large scale infrastructure projects and could therefore require debt funding at the start-up/construction phase of the project. If commercial interest payments are disallowed when calculating taxable profits an operation could be, from a cash flow perspective, making losses yet from a tax perspective in a profit-making position and required to pay corporation taxes. Ensuring that these financing costs are deductible for tax purposes is critical.

However, there is a risk of abuse where such subsidiaries are over-leveraged purely for tax purposes. To combat this risk many countries have introduced various types of earnings stripping rules. In depth discussion of how these rules work is outside the scope of this paper.

An approach that accommodates more commercially highly geared projects (that might otherwise breach fixed earnings stripping limits) could be modelled after the UK's public benefit infrastructure exemption which allows infrastructure which is provided to a public authority, or whose use is regulated by an 'infrastructure authority,' to be exempt from rules which overly restrict debt deductibility, and thus allow the project's overall after-tax cost to users to be more affordable, and make such projects more 'bankable'.

Comments	
Question posed to participants:	*Should there be specific rules which ensure that reasonable, commercial financing costs are deductible in determining profits in the QCAP and are not restricted by local legislation?*
Summary of responses	During the GIIA meeting it was noted that it was hard to determine what sort of debt:equity ratio would be used in decarbonization projects before the details of any regime were determined – although generally high-risk projects tend to be financed with more equity and less shareholder or third party debt. During the roundtable, the point was made that a key issue was that any rules which seek to determine an acceptable amount of allowable interest deductions would need to be transparent and provide clarity to all parties. One possibility would be to find an acceptable debt:equity ratio which would apply to all countries participating in a QCAR; alternatively, it could be determined at each country level according to their situation. It was also suggested that any debt:equity rules should also be narrowly defined and should seek to avoid competition between countries.

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Withholding taxes

Withholding taxes are easy to collect and support source taxation but can create double taxation or over taxation. A potential solution is for a QCAE and QCAI to be exempt from all withholding taxes. A full exemption from withholding taxes means tax treaties do not have to be present, or relied upon, so there should not be concerns about principal purpose test in treaties or anti-abuse rules in EU Directives.

If a QCAE could invest in a QCAP in another jurisdiction (e.g. through a branch) it would be necessary that there was no branch profits remittance tax and also an exemption at the QCAE level for the branch profits.

Comments	
Question posed to participants:	*Should a QCAR contain an exemption from withholding tax on all remittances (dividends, interest and royalties)?*
Summary of responses	Participants – especially from the investor community - agreed that removing withholding taxes would be important, so as to make investments in developing countries comparable with those in developed ones. Withholding taxes can create complexity and in particular uncertainty (particularly where exemptions are available but entitlement to such exemptions are inconsistently interpreted and applied by tax authorities in different countries), both of which are barriers to investment. However, it was noted this may be difficult in some developing countries which have issues in applying transfer pricing rules and have concerns that their tax systems can still be manipulated to reduce corporation tax. While withholding taxes can be administratively complex to apply they give such governments some assurance of being able to collect some tax. The participants discussed that some countries have revised their bi-lateral tax treaties in recent times to be able to apply higher withholding taxes. Ultimately countries would need to carry out a case by case analysis on whether or not reducing withholding taxes would increase investment and so lead to a greater tax take (including personal and indirect taxes as well as corporation tax) in comparison with the tax forgone.

Offshore gains

It is assumed that a sale of assets by a QCAE would be taxed under normal local rules.

Many countries also tax gains made by non-resident investors from the sale (directly or indirectly) of shares in land rich companies. The paper released by the Platform for Collaboration Tax on The Taxation of Offshore Transfers suggests countries may wish to extend taxing rights to include where value comes from government licenses etc.

There are arguments for saying that offshore capital gains should not be taxed within a QCAR, at least to the extent that the gain is attributable to value created by the investment, for example in infrastructure. Any gain realized by the offshore investor can be seen as a return in respect of the risk taken and should, eventually, be taxed in the investor jurisdiction. Additionally, neither the sale nor new ownership, should impact the amount of tax which can be collected from the QCAE on its operations by the local government. While these arguments could be extended to exempting all offshore capital gains - even if derived from the value of the underlying land - it is unlikely that jurisdictions would want to give up this right as it could result in offshore investors gaining from the rise in land value due to public expenditure on infrastructure (e.g. water supply or extended road networks).

An issue with exempting any part of the offshore capital gain would be that there would, potentially, be a difference in treatment between offshore investors and domestic investors who may be subject to tax on disposal under the normal domestic rules. Such a regime could therefore be seen as incentivizing offshore holding of key infrastructure related to decarbonization. However, whether or not the difference arises does depend upon the domestic treatment of the sale of shares. Furthermore, as regards Low Income Developing Countries, it is unlikely that a significant amount of the investment would come from a resident tax base.

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Comments	
Question posed to participants:	*Should offshore gains not be taxed within a QCAR or only be taxed in as far as they are directly referable to an increase in land value?*
Summary of responses	Several participants had direct experience of trying to navigate offshore capital gains rules as investors and they generally agreed that it seemed unlikely that a move away from the international tax norm of taxing land rich companies could be achieved. They also agreed that the issue with offshore gains taxation is not in the principle behind the rules, but the operation of the rules in many developing countries as they leave a huge amount of uncertainty when determining the tax base or the calculation method. It would be acceptable to maintain offshore capital gains rules within the QCAR provided they are clear and provide certainty. During the GIIA meeting one participant noted there are particular problems in applying indirect offshore capital gains rules where a transfer is made indirectly by an investor e.g. from the higher part of the holding chain. A suggestion was made that there could be acceptance that the type of decarbonization projects envisaged would not (usually) involve “land rich” companies and that the value was in the technology and infrastructure and so the application of such rules should be very limited.

Tax certainty

As stated above, tax certainty is a key issue for investors especially when considering projects with a long investment horizon. Known tax costs can be factored into modelling but sudden changes can potentially render a project unprofitable.

Tax stabilization agreements have sometimes been used to give investors security that rules will not be changed to encourage long term investments. However, they have been heavily criticized as being inflexible and tying governments hands in an unacceptable way. Where an agreement is given to a particular company but is not generally available, there are also concerns about undue influence or a lack of a level playing field.

Nevertheless, there is a real tension between the needs of investors to have certainty and the needs of government to be able to adapt laws as circumstances change. Rather than using individual stabilization agreements, one approach could be to allow a QCAE/QCAI to make an election for the regime to apply for, say, a 15-20 year period. The election would be renewable on an annual basis. Such rolling election facilities have been used, for example, in the UK tonnage tax regime for shipping. Ultimately a government could revoke the legislation, but the election mechanism should give a reasonable expectation that the remainder of the election period would not be affected by any changes.

Comments	
Question posed to participants:	*Should the QCAR contain a rolling election and if so for what period? Alternatively, should tax stabilization agreements be considered?*
Summary of responses	One participant noted that from an investor perspective although they would like certainty for the entire life of the investment, they could not expect governments to enter into such agreements, so perhaps 15-20 years would be a compromise, given the long term horizon of such investments.

Other anti-avoidance measures in force in the investor jurisdiction

The QCAR regime may offer significant tax concessions and it would be necessary to help ensure that the jurisdiction in which the investor, QCAI or QCAE resides did not impose rules which unwind the tax neutrality of the structure.

For example, if the investors were a smaller number such that some measure of control was retained over the QCAP then it would be necessary to aim to ensure the Controlled Foreign Company rules did not apply.

Comments

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Question posed to participants:	*What other anti-avoidance provisions should be considered?*
Summary of responses	Participants thought that these would very likely be dependent on the definition of a QCAP and how this would be regulated and monitored.

Tax Residence

Some jurisdictions determine the residence of companies by where they are incorporated. However, many apply a central management and control test – sometimes in conjunction with an incorporation test. The central management and control test sometimes results in directors flying to distant countries to take part in board meetings purely to help ensure that the residence of a certain company cannot be challenged. From an environmental perspective it does not make sense for tax rules to incentivize unnecessary air travel. An alternative could be for all countries to move to the incorporation test (with adequate transitional rules or grandfathering to avoid an unintended or planned change of residence); alternatively, it could be accepted that for a company covered by the QCAR the incorporation rule would apply irrespective of the general rules. Such a rule could be particularly important for a QCAI. Another potential benefit of an incorporation test could be that it allows a focus on governance and choosing the right directors without the need for concerns about the location.

Comments	
Question posed to participants:	*Is there merit from an environmental perspective in applying an incorporation test to decide residence rather than a central management and control test? If so, what safeguards, such as substance tests, would be needed to avoid abuse?*
Summary of responses	Many respondents indicated there was merit in such an idea although one participant in the GIIA meeting wondered if it might just open a new set of complexities and issues. There was general agreement that the substance safeguards would be key. One issue identified was where a QCAP was not in the same country as the QCAE (incorporated entity); the QCAP in that instance would need to be taxed as a permanent establishment (PE) of the QCAE. However, many less developed governments struggle to identify PEs and tax them appropriately. One safeguard could be to require the QCAE to be incorporated in the QCAP jurisdiction. Given there is obvious substance to the QCAP (being the infrastructure project), the incorporation test in this instance should be sufficient to determine tax residence.

Comments	
Question posed to participants:	*Do the participants have any other things they would like to raise?*
Summary of responses	It was noted that the definition of valid carbon abatement projects is one of the biggest issues facing, not only a regime like this, but also the wider carbon abatement agenda. It relies on trust in projects which must be based upon the integrity of the data which not only identifies carbon abatement but measures the amount of abatement accurately. It would not be feasible to ask developing countries to potentially give up tax revenues without being able to prove that there are positive externalities of contribution to carbon abatement. To make it work the definition of carbon abatement should be narrow and very clear.
	The importance of working with governments not only on the interaction and operation of tax rules but on how these impact other parts of the regulatory system was also raised. The example was given of countries which operate an Emissions Trading System (ETS): care would need to be taken to help ensure that if a QCAR regime resulted in a reduction in emissions which gave rise to there being surplus emissions allowances, government policy would need to be coordinated so that allowances in the system were reduced accordingly so that the ETS would continue to effectively drive decarbonization.

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