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Pillar Two: Insurance's industry main concerns and proposed simplifications

The Global Federation of Insurance Associations (GFIA) gratefully acknowledges the consideration given to the industry's concerns and suggestions as expressed in previous submissions and the will to design effective simplifications to improve the manageability of the rules applicable.

Pursuant to the G7 agreement and the latest statement from the G20 Finance Ministers and Central Banks Governors, GFIA understands the Inclusive Framework is actively working on means to enable the smooth coexistence of the US and the OECD Pillar Two global minimum tax regimes.

As fifty-five jurisdictions have already implemented Pillar Two global minimum tax rules, GFIA believes a level-playing field among in-scope MNEs can only be achieved by designing significant simplifications to the OECD Pillar Two global minimum tax regime.

It is paramount for GFIA's member associations to reduce the administrative burden incurred by the implementation of Global Anti-Base Erosion (GloBE) rules and to address inconsistencies between GloBE rules and national taxation rules. Simplifications are needed by MNEs across jurisdictions to ensure a smooth application of Pillar Two rules and avoid adverse side-effects of the complexities inherent to said rules, such as cases of double taxation, which contradict the rationale of the minimum tax principle. The simplifications proposed in the GFIA paper below may be included in a Pillar Two Permanent Safe Harbour or as part of the comprehensive GloBE rules.

GFIA thanks you for considering the concerns and suggestions hereafter detailed and remains available for further discussions.

Executive summary

- **Outline of the future dual global minimum tax regime**

The United States has explained the need for a side-by-side application of the US and the OECD-designed global minimum tax that is supported by the G7. The G20 recently committed to facilitate further progress to stabilise the international tax system, in close cooperation across the membership of the OECD/G20 Inclusive Framework, while preserving the tax sovereignty of all countries. Following G7 and G20 statements, there is an urgent need for a framework that would implement and clarify the rules applicable to MNEs, as questions arise for US MNEs or MNEs with US-parented sub-groups.

- **Permanent Safe Harbour – Investment Entities' treatment for regulated financial MNEs**

As noted in previous GFIA and joint submissions, the treatment of investments in Investment Entities is a major pain point for the industry. Holding interests in funds is instrumental to the insurance business and is monitored by supervisory authorities. It is a common feature for regulated financial activities.

While there are ongoing discussions on designing simplified effective tax rate (ETR) calculations, GFIA insists that this core feature should be taken into account for a simplification of the rules applicable to insurers.

GFIA thus urges you to introduce an election for the inclusion of the Constituent Entity-owner's annual mark-to-market movement of its interests in in-scope funds in its jurisdictional ETR calculation. This election should be open to insurance MNEs, regardless of the location of the fund, with appropriate guardrails, to ensure consistency with GloBE rules.

- **Proposed simplifications to address insurance-specific pain points**

This paper outlines a series of proposed simplifications to address specific insurance pain points relating to Investment Entities, Tax Transparency and Taxable Distribution Method elections, ETR calculation and GloBE adjustments.

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Permanent Safe Harbour – Investment Entities' treatment for regulated financial MNEs

1. Mark-to-market-movement inclusion in the owner's ETR

Along with other regulated financial institutions, insurers and reinsurers should be allowed to opt for the inclusion of the Constituent Entity-owner's annual mark-to-market movement of its interests in in-scope funds in its jurisdictional ETR calculation whether this movement is included in group Generally Accepted Accounting Principles (GAAP) results, or not. In that case, no separate calculation of the fund's ETR or undistributed income and therefore no separate reporting of the fund in the GloBE Information Return (GIR) would be required. Any income taxes paid by the fund should also be pushed up to the owner, where it can be included in the amount of tax in the numerator of the ETR.

The proposed simplification would be applicable where interests in the fund are held in connection with insurance business.

The proposed simplification operates similarly to the special rule for investment entities in the transitional Country-by-Country Reporting (CbCR)-Safe-Harbour but extends the safe-harbour benefits to an investment entity located outside the jurisdiction of the owner. This is justified because in most cases the global tax burden relating to participations in a fund is higher than the minimum tax rate. Furthermore, taxation systems usually aim at taxing funds' income, so the tax burden is the same as if the fund's owner(s) had directly received the investment income. Therefore, it seems sensible to use the same logic under the GloBE rules.

The proposal would thus better reflect the intended tax neutrality in respect of investment funds as initially stated in the Pillar Two Blueprint released in October 2020.

It provides for a solution when accumulating funds that are not eligible for the tax transparency regime in their jurisdictions and thus confronted with possible top-up tax charges under the current GloBE rules.

This simplification would also deal with the overly complex look-through to the underlying assets where the Article 7.5 election has been made. Currently, obtaining the fund level information for a full calculation is required, and at an individual investor level this is often not available on a line-by-line basis. Allowing the inclusion in GloBE income of the mark-to-market movement would be a simplification with an element of prudence, as non-taxable income in the fund would be reflected in the investors' GloBE income.

Moreover, this simplification would relieve MNEs from a cumbersome administrative burden. Indeed, as an alternative to the tax transparency election under Article 7.5 of the OECD Model Rules, MNEs would normally have to rely on the Taxable Distribution Method election under Article 7.6. Under the rules for this election, the MNE is required to keep track of undistributed fund income which involves tracking distributions, deemed distributions, the fiscal year for said distributions, losses, loss carry forwards and taxes that qualify as Local Creditable Tax Gross-ups. In this context, the Taxable Distribution Method election under Article 7.6 does not provide adequate relief because funds that use fair value accounting are bound to have undistributed income, as unrealised fair value gains in the funds' assets are not distributable. Furthermore, the election may result, in some instances, in a restriction of freedom to invest given the distribution requirement within four years.

The rationale for requesting this simplification is based on regulated financial institutions presenting low risk of using controlled funds to permanently defer tax on passive income. Holding interests in such funds is instrumental to their core function and monitored by Supervisory authorities.

Guardrails can be added as considered appropriate, for example:

- Limiting the election to Regulated Financial Services Groups (the definition designed under Pillar One could be referred to for this purpose);
- Or requiring that the Constituent-Owner be either

- located in a jurisdiction with a nominal tax rate of at least 15% or a minimum rate higher than 15%;
- or subject, as a consequence of either the application of covered taxes or of top-up taxes, to tax on gains/losses or distributions (including deemed distributions) from the Investment Entity at a nominal rate of at least 15% or a minimum rate higher than 15%;

- Or any relevant combination of the above.

2. Transparency treatment of collective investment vehicles for insurers

An alternative to the simplification presented under 1. above may be considered, in the form of a tax transparency election open to all of an insurance group's investments in controlled in-scope collective investment vehicles (insurance investment entities), without requiring a minimum level of taxation on the income deriving from the investment. Indeed, in this instance, the transparency election results in putting the insurer in the same situation as if they had invested directly in the underlying assets.

In this respect, the definition of an insurance group's investments in controlled collective investment vehicles should be widely drawn, to encompass all typical collective investment vehicles in which insurers may hold stakes to back insurance business.

A slightly more targeted version of this proposal would be to focus it simply on those investment entities directly backing policyholder liabilities.

Proposed simplifications to address insurance-specific pain points

1. Extending the four-year period under the Article 7.6 Taxable Distribution Method Election

As stated in GFIA's previous submissions, the four-year period conflicts with provisions in jurisdictions that provide for longer periods of tax-free retention of investment income. It is particularly the case in Germany and France.

For example, Germany´s Investment Tax Act allows for a fifteen-year tax-free retention of certain items of investment income generated by "special investments funds." In France, insurance legislation provides for the payment of returns on capital gains to policyholders within eight years. Likewise, the tax treatment of earnings for holders of an endowment life insurance policy upon redemption is lighter after eight years of duration.

The four-year period disregards the business needs of insurers. Insurers require a steady and stable cashflow to meet their long-term obligations towards policyholders, such as paying out lifelong pension annuities. Consequently, investment income may have to be retained for extended periods until it is used for payments to the insured.

The four-year period would impact severely on the cash-flow management and investment strategy of insurers.

Long durations as a specific feature of insurance business are recognised by the GloBE Rules within the context of the Recapture Exception Accrual under Article 4.4.5 (g) of the OECD Model Rules. This exception could serve as a blueprint for the treatment of retained investment income also.

GFIA thus strongly advocates for the extension of the four-year period, at least for the insurance sector. The adopted period should match local tax legislation or be set at a minimum of ten years.

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2. Undistributed Net GloBE Income in case of Pre-GloBE losses under Article 7.6. Taxable Distribution Method Election

Pre-GloBE losses resulting from unrealised fair value losses should be usable as investment loss carry-forwards under Article 7.6.3 (d) of the OECD Model Rules of the GloBE rules. Otherwise, a subsequent fair value gain occurring in the transition year and subsequent years would be bound to qualify as Undistributed Net GloBE Income since unrealised gains cannot be distributed. The unrealised gains may give rise to top-up tax under Article 7.6.2 (c) of the GloBE rules even where the gain merely represents the reversal of the pre-GloBE fair value loss.

The realisation principle election under Article 3.2.5 of the GloBE rules cannot remedy the situation. The investment entity would have to use a value below acquisition cost as the GloBE value for the investment. When the investment is eventually sold, a gain in the difference between the GloBE value and the acquisition cost would not really be an economic gain and would not be distributable.

3. Optional inclusion of non-portfolio dividends in the GloBE base

To ensure a better alignment with domestic rules, insurers should be allowed to opt for the inclusion in the GloBE base of all non-portfolio dividends considered as taxable under national law, as it would serve as a simplification to reflect this treatment in the ETR calculation.

4. Inclusion of specific in lieu of income taxes in Safe Harbours' ETR calculations

Under Article 4.2.1(c) of the GloBE rules, taxes imposed in lieu of a generally applicable income tax are included within the definition of Covered Taxes. In some jurisdictions (eg the United States), premium taxes are collected in lieu of income tax and are easily identifiable, while such taxes are not always included in the effective tax rate for CbCR purposes.

Any Safe Harbour framework in the GloBE rules should allow for an adjustment to include in lieu of income taxes for ETR test purposes.

5. Further refinement of the Substitute Loss Carry-forward Deferred Tax Asset and the interaction between the US Corporate alternative minimum tax (CAMT) and the GloBE rules

GFIA encourages the further refinement of the GloBE rules relating to Substitute Loss Carry-forward DTA to equitably address and make sure that double taxation does not result in fact patterns when there are domestic source tax loss carry-forwards or the absence of foreign tax credit carry-forwards, as well as providing a mechanism to address the ETR in not only the parent jurisdiction but in the subsidiary or Permanent Establishment jurisdiction.

GFIA also encourages the development of rules to address the treatment of US CAMT tax credits, as outlined in the August 2024 GFIA letter.

6. Exclusion of valuation allowance impact in Safe Harbours' ETR calculations

Under Article 4.4.1(c) of the GloBE rules, the impact of a valuation adjustment or accounting recognition adjustment with respect to a deferred tax asset is excluded. Where a valuation adjustment reduces the reported tax expense, it may lower the ETR, which potentially affects safe harbour eligibility.

Any Safe Harbour framework in the GloBE rules should allow for an adjustment to exclude valuation allowance impacts for ETR test purposes.

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7. Equity investment inclusion election

As noted in GFIA's previous submissions (letters of 9 May 2023 and 13 August 2024), some jurisdictions have concerns with the Equity Investment Inclusion Election as provided for in the consolidated commentary. There is therefore a request for additional guidance whereby an MNE may opt for the equity investment inclusion election on a line-by-line basis with regard to assets held by insurance companies so that, if the election is made by a group with a constituent entity that is an insurance company, the election does not apply to securities held on behalf of policyholders (for example, US separate accounts supporting variable insurance policies and annuities).

Conclusion

Finally, with regard to the global context, GFIA insists on the urgent need for a swift implementation of the US-G7 agreement. MNEs subject to Pillar Two need simplifications, especially given the first reporting requirement due in June 2026. To that effect, the simplifications proposed above can be included in any Safe Harbour framework or the comprehensive GloBE rules.

GFIA thanks you for your kind consideration and remains available for further discussions.

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About GFIA

The Global Federation of Insurance Associations (GFIA), established in October 2012, represents through its 43 member associations and 3 observer associations the interests of insurers and reinsurers in 69 countries. These companies account for 89% of total insurance premiums worldwide, amounting to more than $4 trillion. GFIA is incorporated in Switzerland and its secretariat is based in Brussels.