GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

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GFIA response to the OECD consultation on its report on the Pillar Two Blueprint

Key Issues

Insurance industry: Economic context for Pillar Two

The Pillar Two Blueprint ('the Blueprint") as currently drafted, does not consider the nature of insurance (and reinsurance) and how the global industry operates over the long-term in a highly regulated environment. The GloBE rules have the potential to penalise insurance companies unduly compared to similar businesses in other industries because of the intrinsic nature of the industry. Key issues that need to be considered by the OECD/G20 Inclusive Framework (the 'IF') are:

- Unlike many other industries, accounting results do not directly translate into free cash flows for insurance companies due to regulatory rules and the commercial focus on available funds (e.g. from ratings agencies). It is for this reason that tax rules often follow a regulatory basis with different rules for valuing investment assets and insurance technical provisions. As these comprise the significant items on insurers' balance sheets this commonly leads to timing differences between tax and accounting in the hundreds of millions or billions of Euros, as can be seen by the size of deferred tax assets/liabilities on insurers' balance sheets.

- Timing differences can be very long lasting:
    - Many insurance policies extend over decades. This is common across life insurance (e.g. 20-year term insurance), the long-term savings industry (e.g. pensions and investment bonds) and general insurance (e.g. asbestos and other liability claims that arise decades after the associated premium payments).
    - Overlaid on this long-term view is the impact of the insurance cycle. Large claim events (e.g. hurricanes) and market movements on assets in one year can lead to losses that take many years to recover. Insurers operate a long-term view as part of their business planning. Profitability in any given period is not the key metric – it is the long-term trend.

- Combining these tax and business impacts means that insurers have very significant and very extended timing differences which may take decades to reverse. These differences can result in significant volatility and in insurance operations having an inappropriately low GloBE effective tax rate ("ETR") in any one year that in many cases will not be adequately addressed by the credit and carry-forward mechanism, as described in the Blueprint. GFIA recommends that deferred tax accounting be adopted to eliminate the significant timing differences between financial and tax accounting. GFIA comments on this issue in more detail in section 1 below.

- Substance for an insurer is intrinsically linked to appropriate capital being held in a regulated legal entity. The minimum amount of capital required is set by the local regulatory authority, however the attitude of ratings agencies and insurance counterparties means in practice prudence on top of this minimum must

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be retained by an insurer. This capital is not very fungible, and regulatory rules acknowledge this when looking at the overall group capital position for insurers.

- Insurance premium payments do not correlate to corporate profitability / profit transfer in the same way that interest or royalty payments do, which can reflect largely risk free, continually profitable business models. Indeed, substantial premiums can be received by an insurer even where that business is ultimately loss-making. GFIA comments further in section 2 on this key issue in the context of the Subject To Tax Rule ('STTR').

GFIA requests that the IF considers the points made above. GFIA notes that in Pillar One the IF has recognised insurance is unique.[1] Similarly, the regulated nature, specific tax rules and long-term business cycle of insurance and reinsurance means that the current Pillar Two rules do not work in a fair way for the industry. Should the existing Blueprint proposals be implemented then in some respects Pillar Two rules will need to be applied differently for insurance and reinsurance than to other industries.

Other specific issues

There are a number of other issues that are not covered by consultation questions, which GFIA isconcerned about. GFIA comments further on these issues in section 3 below.

Answers to consultation questions

GFIA has not attempted to answer every question in the consultation, but GFIA has provided answers to those questions of most importance to the insurance industry in section 4 below[2].

[1] The unique position of the insurance industry is acknowledged in the Report on the Pillar One Blueprint at para 133 which states "Insurers measure income and costs differently than other industries so traditional profit measurements might inaccurately result in excess profits that do not in reality exist. Most industries incur costs such as labour, raw materials, etc. at an early stage in the business cycle, with the corresponding revenues generated later in the process. The opposite is true of insurance: insurers collect premiums upfront but incur unpredictable costs later – sometimes much later – when they pay claims. The effect of these types of losses on the insurance industry is unique. The insurance industry's role is to assume risk over many years, with an uncertain realisation and timing of the insured event. This exposes the industry to volatile profits and losses. Premium rates change over the cycle depending on the availability of capital. During a soft market (when capital is plentiful), competition reduces premium rates. But as the market hardens (when capital becomes scarce, typically after a major catastrophe), premiums rise. This creates a multi-year business cycle unique to the insurance industry. Current year profits are often based on insurance reserve estimates that reflect losses that may (or may not) occur and are based on complex actuarial modelling techniques. The ebb and flow of the insurance cycle makes the determination of normal returns for the industry difficult."

[2] An overview of how the global insurance industry operates can be found in the Association of British Insurers' (ABI) attached to its separate response to this consultation.

I. Carry-forwards and carve-out

a. Timing differences: Income Inclusion rule

The Blueprint generally:

- Provides that the ETR is calculated on a jurisdictional basis by dividing covered taxes (without taking timing differences into account) by the amount of income within the company's financial accounts that are prepared under the same accounting standard that is used by the parent, with certain adjustments.
- Does not provide for adjustments for the significant book/tax differences that impact the insurance industry, creating a mismatch at the jurisdictional level.

This discrepancy will have systematic and material impacts on the insurance industry significantly greater than many other industries. The most material differences for insurers arise from the largest items on the balance sheet:

- Insurance technical provisions
- Investments

Insurance technical provisions

Insurance technical provisions include liabilities to pay future benefits to policyholders and assets such as deferred acquisition costs ('DAC'). The policyholder reserves are almost always the largest liabilities on an insurance company's balance sheet – and are generally multiple times larger than an insurance company's equity capital. The accounting and tax rules for calculating these liabilities are often different, and even a small percentage valuation difference for such large balance sheet items can create significant timing differences. A couple of specific examples are included below, but this is a global issue:

- In the US general insurance industry, tax reserves are discounted to fair value and are therefore generally less in value than the nominal value under US GAAP accounting rules.
- In some European countries, additional regulatory reserves (liabilities) are included in tax basis calculations, but not accounting calculations.

Regulatory reserves (such as equalisation/safety/contingency reserves in European countries) are liabilities which are set to ensure that the insurance company will remain solvent under moderate to severe adverse scenarios to meet its long term promises to policyholders and their beneficiaries. In contrast, financial statement accounting is intended to provide investors, not regulators, a view of the company's profitability in the reporting period and to give investors a basis for comparison of products and companies.

Even where Solvency II has superseded national regulatory rules, tax rules often still follow the traditional regulatory basis of calculating insurance reserves. The reserves are formulaic, incorporating an insured's premium income levels and the difference between the current period's claim activity and normalised claims activity, subject to a cap. As a result, an insurance company is required to increase reserves in "good" years, which are then used to fund policyholder payments in "bad" years. Generally, increases to reserves are tax deductible and decreases in reserves are included in taxable income, thus equalising results over time. There is usually no time limit after which unused reserves are returned to general funds. The reserves fully reverse only if / when the insurance company winds down its affairs.

Similarly, acquisition costs of insurance are significant, and they are often capitalised as DAC and spread over the life of the policy for accounting purposes. However, the tax rules regularly differ, with significant timing differences due to the prescriptive spreading rules required for tax purposes (e.g. 15 years US, 7 years UK) diverging from the accounting spreading both in length and pattern of amortisation.

Investments

Insurance companies are recognised as some of the largest investors in the economy. They invest for the long term to match investments with long term liabilities to support their promises to policyholders. The Balance Sheet valuation of investment assets can therefore be of a similar magnitude to insurance technical provisions. The financial reporting regime may require mark to market accounting, while tax rules require realisation to recognise gains and losses. In certain jurisdictions, the opposite can be true. The timing differences related to investments are therefore volatile and material.

Carry-forward model application

While the Blueprint includes a carry-forward mechanism to help address timing differences, the examples below show that an insurance company with typical reserve liabilities would frequently not benefit from this. An Income Inclusion Rule ('IIR') tax credit or local tax carry-forward would not be created until the reversing year, which could be long after the year in which the top up tax is paid for reserve differences, particularly for a growing business or long duration insurance products. In other cases, where the IIR tax credit and local tax carry-forward were time limited they would expire before the timing difference reversed. These models also do not address when an entity is subject to the UPTR as a result of timing differences, which is further explained below.

Critically, so long as an insurer maintains a steady book of business, or increases its book of business, the existing reserve differences are replaced with those arising from new business. As such they will not reverse for a long time. Again, this means the IIR tax credit or loss carry-forward would be ineffective in eliminating the effects of this timing difference.

Carry-forward models would therefore have permanent tax rate impacts in excess of the proposed GloBE minimum and a penal cashflow and opportunity cost impact on the insurance industry.

In contrast, incorporating deferred taxes based on factual timing differences identified in regulatory / tax basis calculation methodologies would remedy this volatility by creating basis parity between the Pillar Two ETR's numerator and denominator. Administrative burden would be reduced compared to current proposals because deferred taxes must be determined for financial accounting purposes and source information is therefore readily available.

Example 1

In this example, regulators in the relevant country require an additional reserve for prudence which reduces taxable income initially e.g. European insurance business:

Item	Origination year		Reversing year	
	Current IF proposal	Regulatory / tax basis	Current IF proposal	Regulatory / tax basis

Pre-tax income – group GAAP	1,000	1,000	1,000	1,000
Regulatory & tax basis adjustment	(600)	(600)	600	600
Jurisdictional taxable income	400	400	1,600	1,600
Cash taxes at 22%	88	88	352	352
Timing difference (deferred) taxes	0	132	0	(132)
Covered taxes	88	220	352	220
Pillar Two ETR	8.80%	22.00%	35.20%	22.00%
Top-up tax (12.5% min rate)	**3.70%**	**0.00%**	**0.0%**	**0.00%**

Note the IIR tax credit carry-forward or local tax carry-forwards do not provide any benefit in this example, as there is no further Pillar Two IIR top-up tax liability. This therefore is a permanent additional tax.

Example 2
In this example, the regulatory / tax reserves are lower than the accounting reserves so the taxable profit in the originating year is higher than the accounting profit e.g. US general insurance business:

Item	**Origination year**		**Reversing year**	
	Current IF proposal	**Regulatory & tax basis**	**Current IF proposal**	**Regulatory & tax basis**
Pre-tax income – group GAAP	1,000	1,000	1,000	1000
Regulatory & tax basis adjustment	600	600	(600)	(600)
Jurisdictional taxable income	1,600	1,600	400	400
Cash taxes at 22%	352	352	88	88
Timing difference (deferred) taxes	0	(132)	0	132
Covered taxes	352	220	88	220
Pillar Two ETR	35.2%	22.00%	8.80%	22.00%
Top-up tax (12.5% min rate)	**0.00%**	**0.00%**	**3.70%**	**0.00%**

Note in the example above the carry-forward attributes (which are time-limited unlike losses) are presumed to have expired due to the long-term nature of insurance business and are hence not available in the reversing year.

Conceptually there are three ways to deal with book/tax differences:

i. deferred tax accounting;

ii. making adjustments to the GloBE tax base for significant book/tax differences; and

iii. a carry-forward or credit mechanism.

The Blueprint adopts a combination of (ii) and (iii). However, while the Blueprint makes adjustments to the GloBE tax base (the denominator) for some industries' significant book/tax differences, it does not address the significant book/tax differences for the insurance industry – namely insurance technical provisions and investment accounting. That means the insurance industry is left with the carry-forward and credit mechanism, which results in both cashflow and permanent tax disadvantages where the timing differences are over extended periods.

Making adjustments to the GloBE tax base to take into account timing differences solely related to insurance technical provisions and investment accounting could work in theory, but in practice the rules are unlikely to fully address the important book/tax differences for all industries.

GFIA's ask

GFIA therefore asks that the significant tax / accounting timing differences are dealt with under Pillar Two in a way that does not prejudice sustainable insurance businesses. GFIA's preferred solution is deferred tax with an unlimited carry forward, as this eliminates significant timing differences due to differences in valuation of investment assets and insurance technical provisions between tax and accounting results in a well understood manner.

GFIA understands there is concern over the ability of organisations to influence deferred tax impacts. GFIA does not take the view that these are well founded concerns due to the scrutiny of auditors and the wider impact any manipulation would have on financial statement results used by other stakeholders such as investors. Should areas such as uncertain tax positions or valuation allowances be particularly sensitive, an alternative would be to provide for deferred tax as an option for timing differences explicitly evident in submitted tax computations which would include insurance technical provisions and investment assets within regulated insurers. This could be subject to a materiality threshold where required. There are however drawbacks to this modified approach as it would create significant additional compliance complexity.

Should this not be acceptable, a further alternative could be to adjust the denominator of the GloBE calculation for specified timing differences such as technical provisions and investment assets where adjustments are made in submitted tax computations. This would have similar complexity to the modified deferred tax approach mentioned above, but would potentially be more acceptable to all stakeholders, as those differences are already identified and monitored as part of a company's required deferred tax accounting processes.

b. Timing differences: Pre-regime loss carry-forward provisions

As summarised in the Blueprint, failure to take appropriate account of pre-regime losses and timing differences could result in an MNE Group being overtaxed, by converting what was essentially a timing difference into a permanent difference based on the mere fact that the MNE Group was brought within the scope of the GloBE rules after those attributes arose. The Blueprint proposes the development of transition rules to address these concerns. GFIA has focussed comments below on losses, but they apply to timing differences equally.

GFIA has two concerns with the transition proposals in the Blueprint.

1. The Blueprint suggests that the transition period for determining pre-regime losses will be limited, perhaps to seven years. Some insurance groups are still utilising losses that are substantially older than the seven-year period that has been proposed; thus, a seven-year look-back period would materially distort the computation of those groups' GloBE ETRs. There is no compelling reason articulated why the policy rationale supporting the indefinite carry-forward of post-implementation losses would not be equally applicable to pre-regime losses. GFIA is of the view that – like the post-implementation loss carry-forward – the look-back period for transition losses and other timing differences should be indefinite to provide for industries with very long business cycles and tax regimes that apply loss restriction rules (e.g. limited to 50% of taxable profit as in the UK). Alternatively, the transition loss-carry-forward provision could allow taxpayers to use their local tax loss carry-forwards and material timing differences as of the inaugural date of the GloBE proposals to determine the GloBE tax base.

2. The Blueprint indicates that the "most accurate" approach would be to identify an applicable start date for the transitional period and require an MNE Group to compute an opening balance of its loss carry-forward

and local tax carry-forward as if the GloBE rules had applied during the transition period. The Report also considers the development of a “simplified method” that could produce results that reasonably approximate the “more accurate” approach with less complexity and administrative burden. While GFIA endorses efforts to reduce complexity (particularly in light of the highly complex nature of the GloBE provisions overall), given the considerable importance of the loss carry-forward provisions to certain cyclical business sectors, GFIA supports the application of the “most accurate” approach as the default means by which pre-regime loss and local tax carry-forward attributes are determined, with an optional “simplified” approach which MNE Groups may choose to apply (e.g. where an MNE Group is not disadvantaged by the less accurate approach and/or wishes to reduce complexity and its administrative burden).

GFIA’s ask

Most (or all) of these issues would be effectively addressed by the adoption of a more accurate and straightforward model that takes deferred tax accounting principles into account, as summarised above.

Should deferred tax accounting principles not be adopted in full, then applying them to the transition into the new regime would alleviate the issues currently identified on the transition. Should neither of these be possible, in determining the pre-regime local tax carry-forward MNE Groups need to be permitted to apply the “most accurate” approach. In practice, certain MNE Groups may opt to limit the application of the “most accurate” approach to a shorter period for practical reasons.

c. Timing differences: Undertaxed payment rule

The credit and carry-forward rules will often be ineffective when applied to the UTPR regime. The proposed cap to mitigate the impact of the UTPR only provides a rule to mitigate the amount of tax payable and does not consider previous or future amounts of tax paid, if any. Consider the example of a company with a low ETR from timing differences in a country that has adopted the GloBE rules. In that case, the UTPR may be imposed by countries if the company has affiliates making payments to it. If after a number of years those timing differences reverse and drive the ETR of the company in excess of the minimum tax rate, there is no mechanism for a credit or refund of the UTPR. Moreover, a proposal to increase deductions in a later year to the UTPR taxpayer may be ineffective since that relies upon the UTPR taxpayer having a tax liability in the later year while still being affiliated with the company. As discussed previously, deferred tax accounting or a similar mechanism should be used to address this and other concerns. If deferred tax accounting is not used, GFIA suggests that the UTPR credit rules be written such that the company jurisdiction gives the company a credit for the UTPR paid by its affiliates, or the jurisdictions in which the affiliates paid tax need to refund that tax.

GFIA’s ask

The UTPR cap and related rules need to take into consideration the long term and integrated nature of reinsurance, that includes reserves movements charged to profit and loss where they are established to represent future cash flows and have a credit mechanism for the refunding of excess UTPR paid as a result of timing differences.

d. Substance carve-out

See answers to specific questions in section 4.

II. Subject to tax rule ('STTR')

GFIA is of the view that insurance premiums should be distinguished from other intragroup payments for STTR purposes. As outlined further below, the STTR relating to insurance or reinsurance premiums seems to disregard the economic realities in the insurance sector and would likely result in over-taxation.

Critically, the statement at paragraph 601 of the Blueprint that: *"If the risk does not materialise, the insurance or reinsurance premium can generate a high return."* misses the fundamental point of insurance. If the risk does materialise, a loss far exceeding the initial premium payment can arise – i.e. the risk of the adverse event occurring has been assumed by the (re)insurer. The OECD has acknowledged in previous reports, that premium should not be thought of as pure income, leading to high returns "if" losses do not materialise, but rather that it is of the essence of insurance that although premium income may be reported as income in the current year, "a substantial portion of the [premium] income is simply to fund future expected loss payments".[3] The OECD has also considered factors that can indicate there is genuine insurance business and transfer of risk.[4]

a. Risk of substantial over-taxation

The envisaged withholding tax potentially leads to over-taxation because it would be levied on the gross amount of a payment. This would hit particularly hard those companies whose sole or main source of turnover was subject to such a withholding tax, as would often be the case for reinsurers of MNE insurance groups. A likely consequence would be that the withholding tax would push the effective tax rate in the payee jurisdiction far above the minimum tax rate resulting in a perpetual building up of the local tax carry forward in the insurer jurisdiction which may never be used.

As shown in the examples below, the over-taxation resulting from the application of the STTR should not be seen as a one-off event in a single year but rather as a more or less prevailing situation. The STTR would work as a turnover tax, possibly in addition to an insurance premium tax levied on the same payment. This would result in penal tax where losses result and cannot be justified as a BEPS counter measure.

Example (based on Blueprint example 10.2.1A)

- B Co 1 pays 900 of reinsurance premiums to C Co 1.
- Country C has a corporate tax rate of 5%.
- C Co 1 also has 100 taxable investment income.
- Income of C Co 1 overall is 145 (The combined ratio - i.e. losses and expenses as a proportion of premium - is 95%, giving an underwriting profit of 45 (5% of 900) to add to the investment income of 100).
- Hold Co is subject to an Income Inclusion Rule in Country A. Countries B and C have a tax treaty that follows the OECD Model Tax Convention and contains a STTR.

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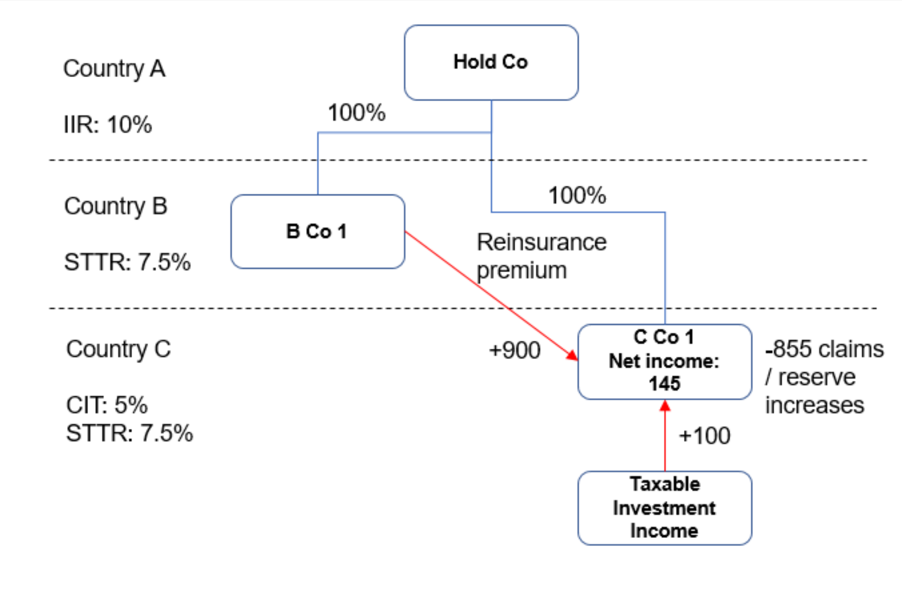
[3] Discussion Draft of the Report on the Attribution of Profits to a Permanent Establishment, Part IV (Insurance), paragraph 14 (2005).

[4] OECD Transfer Pricing Guidance on Financial Transactions paragraph 199

- The minimum adjusted nominal tax trigger rate for the purposes of the STTR is 7.5% and the minimum rate for the GloBE rules is 10%.



- A 2.5% (7.5% - 5%) STTR withholding (=22.5 tax) applies to the reinsurance payment from B Co 1 as the country C nominal tax rate is lower than the 7.5% trigger rate.
- C Co 1 suffers a 5% local tax charge (=7.25 tax) on the tax base (profit) of 145.
- Total covered taxes for C Co 1 are 29.75 giving a total rate of 20.5%.
- The IIR does not apply at Hold Co level as the total rate is 10.5% above the IIR minimum tax rate of 10%, with 15.25 of additional tax charged. This results in a local tax carry-forward.
- If only the IIR rule were applied, only an additional 5% Pillar Two IIR tax (= 7.25 tax) would have been triggered at the HoldCo level, giving a total ETR of 10%.

Critically, assuming similar reinsurance premiums and profitability in future periods, the STTR withholding will routinely swamp any possible IIR top-up. The local tax carry-forward would only be utilised where the reinsurance volume fell significantly, or profitability was far higher than the assumed 95% combined ratio.

b. Differentiation between captives and reinsurance entities of insurance MNE groups

The undifferentiated inclusion of (re)insurance premiums in the high-risk service category seems unfounded and would have undesirable economic effects on well-established business models in the insurance sector. The example of captives mentioned in the Blueprint is not comparable to the business model of globally operating insurance companies. There is a distinction between a captive (of an MNE group) and a reinsurance entity (of an insurance MNE group) which should be reflected in the Pillar Two rules, as is acknowledged in the OECD Transfer Pricing Guidelines on Financial Transactions.

A captive on the one hand may insure exclusively or almost exclusively risks of entities of the MNE group to which it belongs. A reinsurance entity on the other hand insures risks of unrelated parties that are insured by other entities of the MNE insurance group to which it belongs. This is a genuine and normal part of the business model of insurance groups.

The reinsurance entity is a regulated company and therefore subject to regulatory requirements which ensure that it has the financial capacity and the necessary personnel to assume risks from the insured customers.

Equally the cedant insurer is also subject to regulation and is usually required to hold capital against the counterparty risk of the reinsurer (whether an internal or an external reinsurer). The regulators of the cedant insurer will also be concerned that the terms of the reinsurance are arm's length (in order to protect the solvency position of the insurance cedant).

c. Transfer pricing comparables are available

The assumption in section 601 of the Pillar Two Blueprint that it would be hard to find comparable unrelated transactions to test whether the pricing of intra-group transactions meets the arm's length principle seems unfounded as they can be commonly found from contractual insurance and reinsurance arrangements with third party customers.

Furthermore, since the new chapter X of the OECD Transfer Pricing Guidelines with a chapter dedicated to captive insurance has been adopted, there are existing international transfer pricing rules which address low substance captive structures, effectively mitigating the risk of artificial BEPS resulting from (re)insurance transactions.

d. Detrimental effect on economically driven business models and group structuring

The withholding tax under the STTR would work as a disincentive for spreading insurance risks among group members, since it raises the costs for buying intra-group reinsurance policies. The consequence may be the accumulation of insurance risks in countries that have introduced the STTR. Such intra-group structures are required to address requirements imposed by regulators worldwide, which seek to ensure high capital levels for (re)insurers to protect the insured against the potential default of their insurance policies. A less efficient allocation of (costly) capital and risk, and an additional cost component by an imposed withholding tax on (re)insurance premiums, would increase the pressure on prices of end-consumer insurance products, which is already affected by increasing withholding tax requirements worldwide.

e. Brokerage fees

In addition to the points noted above, paragraph 591 identifies brokerage fees as being within scope of the STTR. Insurance broking is a widely used commercial transaction both within groups and with third parties. Insurance brokers as well as insurers are typically subject to local regulation which requires local substance. Most transactions between insurers and brokers are co-jurisdictional but there are some cases including using EU freedom of services where they are not. It is not clear from the Blueprint whether insurance broking is intended to be covered by the STTR definition of brokerage fees, however there does not appear to be a reason for doing so. As such, GFIA recommends that it is made clear that insurance broking is not covered by this definition.

GFIA's ask

Intra-group insurance and reinsurance premiums of MNE groups of the insurance sector should be removed from the scope of the STTR. Similarly, insurance broking transactions should not be within the scope of the STTR.

As there is considerable complexity in the STTR interacting with the IIR, GFIArecommends that the IIR is implemented first, with an assessment made of whether the STTR is necessary at a future date.

III. Other specific issues not covered by consultation questions.

a. Compliance complexity

The Blueprint states that it is a “solid basis” for future agreement. GFIA notes that the original intention of Pillar Two was to utilise readily available accounting information and limit the burden on taxpayers and tax authorities to create multiple sets of books and records. As the future agreement on GloBE is further negotiated, GFIA encourages the IF to be mindful of the complexity that is generated from creating new tax basis records. In particular, the Blueprint references the use of consolidated GAAP or IFRS accounting information on a jurisdictional basis. However, many companies’ accounting systems are designed to focus on the accuracy of either entity results or consolidated results and are not designed to produce reliable accounting results by jurisdiction. While the Pillar Two Blueprint states that taxpayers can use entity level information even if it is not prepared in strict accordance with the parent’s financial accounting standard, that information can only be used if it is reasonable, reliable, and does not result in material permanent differences.

There are significant differences between some GAAP’s that apply to insurers, e.g., German GAAP is quite different to US GAAP and could give rise to material permanent differences. Groups affected by such differences would be unable to rely on the use of entity level information and would hence be exposed to potentially material impacts on their ETR calculations. In other cases, it is not clear how broadly those standards should be interpreted, and many taxpayers may not be able to rely on their entity level information to compute their GloBE tax base.

In addition to the concerns raised around deferred tax accounting and carry-forward mechanisms, GFIA is concerned about inconsistent timing and the way countries implement the GloBE proposals. The current GloBE proposals create a high degree of interaction among various taxing regimes. If jurisdictions enact the GloBE proposals without a high degree of consistency, there is likely to be double or multiple taxation of the same profits. Even if jurisdictions implement consistently, but enact the measures at different times, that will lead to tremendous compliance burdens for taxpayers and governments. These same consistency and timing concerns were partially addressed in the BEPS project through the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting. A similar multilateral agreement could be used to implement the Pillar Two proposals and thereby reduce compliance burdens.

If the Inclusive Framework agrees to implement the GloBE proposals using a multilateral agreement similar to that used in BEPS 1.0, GFIA urges the Inclusive Framework to make adoption of the agreement in its entirety mandatory and adopt a uniform date for when the agreement enters into force for all parties, to alleviate the compliance burden of having to comply with several different multilateral agreements entering into force at different times.

b. Covered taxes

Certain taxes calculated by reference to gross premium

Section 3 of the Pillar Two proposals generally define covered taxes as any tax on an entity’s income or profits, including taxes imposed in lieu of a generally applicable income tax. GFIA is appreciative of the acknowledgement in Paragraph 139 that taxes on categories of gross payments such as insurance premiums should be covered taxes to the extent, they are in lieu of a generally applicable income tax.

On this basis, the US federal excise tax, which is paid in lieu of income taxes, would qualify as a covered tax for Pillar Two, which GFIA views as the appropriate treatment. Some US states and other territories such as France (with the contribution on corporate added value), Japan and Hong Kong impose premium and similar taxes on insurance companies in lieu of state/domestic corporate income tax. Because the premium tax is specifically in lieu of corporate income taxes, the premium taxes would also qualify as a covered tax under Pillar Two, which GFIA views as the appropriate treatment.

c. Investment returns of life insurance policy holders

The GloBE rules should deal with diverging revenue definitions under IFRS and national GAAP. Differing treatment exists for certain insurance products. There should be a common definition for purposes of the EUR 750 million revenue threshold which determines whether an MNE group is within scope.

As paragraph 218 of the consultation notes, many long-term insurance products include an element of savings and investment assets. For example, under German GAAP all such income is recognised as revenue although it would not be under IFRS. A revenue threshold for inclusion in the regime of EUR 750 million, could result in insurers being brought within scope as a result of German GAAP including policyholder related items within revenue that would not be included within the equivalent IFRS revenue.

A similar issue arises where income arises from the investment assets held for the policyholders, such as portfolio dividends and interest income. These income streams should not be regarded as revenues for purposes of the EUR 750 million threshold.

Paragraph 218 in the Blueprint provides a carve out for returns where assets are beneficially owned by policyholders. The intention of the policy is clear; where asset returns are attributable to policyholders not shareholders they should not be within the scope of the rules.

Using the term “Beneficial” ownership is however restrictive language when looking at the commercial objective and in the specific context of investment funds. Assets held by an insurer are beneficially owned by the insurer not the policyholder, notwithstanding that commercially the economic benefits will flow to the policyholder (except for example on an insurer insolvency event). As such, the wording should be amended to be clear that where the economic risks and rewards of ownership of the investment asset are held by policyholders a permanent adjustment should be made to the insurer’s GloBE tax base for the purposes of calculations in all jurisdictions, not just the jurisdiction in which the policyholder liability is ultimately booked. This is as income may flow through multiple funds in different jurisdictions (and hence be included in their tax base) while the liability to the policyholder would only be booked for accounting purposes within the insurance company.

This clarification would mitigate the impact of some investment fund definition issues that arise for insurers and GFIA refers to in the answer to questions on Chapter 2. (GFIA notes that where both the income and increase in policyholder liability were reflected within the same jurisdiction then no adjustment would be required for the purposes of assessing the ETR as they would net off anyway, however they could still be in point for the purposes of the Revenue threshold test).

d. Recognition of national accounting standards (paragraph 173 of the Blueprint)

MNE Groups with a consolidated group revenue threshold of at least EUR 750 million are in scope of the GloBE rules under Pillar Two. Chapter 3.3.3 determines which accounting standards are accepted for the purpose of calculating the group revenue threshold. The Blueprint explicitly mentions IFRS and the national GAAPs of Canada, Japan, China, India, Korea and the USA. Non-listed companies in many cases use other national GAAPs of their home country. If they exceed the EUR 750 million threshold, they are in scope of Pillar Two.

GFIA welcoms the statement in the Blueprint, that other national GAAPs should be accepted if the use of that standard would not result in material competitive distortions in the application of the GloBE rules (see paragraph 173 of the Pillar Two proposals). Ideally specifying eligible GAAPs explicitly would be helpful.

e. Recognition of an unused IIR-Tax-Credit (paragraph 309 of the Blueprint)

GFIA welcomes the discussion within the Inclusive Framework on whether an unused IIR-tax-credit should be creditable against the national corporate income tax. If the IIR-tax-credit can only be used for the GloBE rules there would likely be cases where the tax credit expires as there is no top-up tax under Pillar Two in succeeding years. The situation can arise after a raise of the tax rate in a formerly low taxing jurisdiction.

IV. Answers to consultation questions

II. Chapter 2: Scope of the GloBE rules

a. The treatment of investment funds (as defined in Section 2.3.) under the GloBE rules. [*Refers to paragraphs 76-83 of the Blueprint*]

2. In the case of an investment fund under the control of an MNE Group, what additional rules would be needed to ensure the tax neutrality of the fund and ensure that:

i. the MNE Group's share of the fund's income is not excluded from the GloBE tax base? and

ii. related party payments to and from the fund cannot be used to circumvent the UTPR?

Many life insurers consolidate funds they invest in. These funds are used to pool investments from multiple policyholders investing through the insurer. Typically, the funds will directly back policyholder liabilities, so in the group result there will be a low shareholder profit related to this investment income. There may also be third party investors (individual or corporate) who also invest into the same fund, particularly where an insurer has provided seed capital.

Investment fund example	Lux Fund	UK Life Insurer	Consolidated Group
Gross Income	100	100	100
Policyholder liability increase	0	(95)	(95)
Profit Before Tax	100	5	5
Tax (0%/20%)	0	(1)	(1)

Profit After Tax	100	4	4
Distribution to investors (UK life insurer)	100		
Income inclusion rule tax overlay (10%) levied by UK authority	(10)		(10)
Total Tax levied	(10)	(1)	(11)

Applying Pillar Two top-up tax in this situation would clearly lead to an inequitable result.

All of these funds are commercially run and regulatory rules mean that asset classes life insurers can invest into are strictly controlled.

The consultation paper is concerned about these funds being used to circumvent the UTPR. One way to mitigate this issue would be to protect the tax neutrality of the investment fund where income is taxed within a regulated insurer in a different jurisdiction by treating it as arising in that jurisdiction and excluding the income from the GloBE tax base calculation of the jurisdiction that the fund is resident in (i.e. in the above example, the income in Luxembourg would be disregarded).

III. Chapter 3: Calculating the ETR under the GloBE Rules

a. Treatment of dividends and gains from disposition of stock in a corporation. [*Refers to paragraphs 181-191 of the Blueprint*]

1. Do you have any views on the appropriate ownership threshold and the methodology of how to determine that threshold, both for the exclusion of portfolio dividends and the exclusion for gains and losses on the disposition of stock from the GloBE tax base?

Insurance companies invest as an active part of their business. Many countries apply a dividend exemption rule to mitigate double taxation. Where dividends are excluded from the tax basis of the relevant company, they should therefore also be excluded from the GloBE denominator (subject to a materiality threshold), otherwise double taxation will result. Should this approach not be adopted GFIA has provided further comments below.

The threshold for the exclusion of dividends should be in line with the EU-Parent-Subsidiary Directive. Dividends should therefore be excluded from the income if the shareholder owns at least 10% of the dividend paying company. The 10% threshold is common among the EU member states and functions as a role-model for non-European countries too. As a result, the 10% ownership-test is well practiced and could be integrated in the Pillar 2 rules relatively easily.

In order to achieve the goal of administrable rules and low compliance burdens, there should be no distinction between domestic and foreign participations for an ownership threshold test (see paragraph 185 of the OECD Pillar 2 Blueprint). Such a distinction could also violate the EU principle of free movement of capital.

If a shareholder meets the criteria for the exclusion of dividends it is discussed whether expenditures corresponding with these dividends should be added back to the tax base for purposes of Pillar Two (see paragraph 185 of the

OECD Pillar Two Blueprint). Although from a systematic perspective such a corresponding rule might be comprehensible, from a practical perspective such a rule would be burdensome. (This is also inconsistent with country dividend exemption and dividend received deduction rules that exclude dividends from taxable income to mitigate double taxation, while not excluding corresponding expenses). Furthermore, GFIA does not expect a noticeable effect on the tax base and the ETR. Therefore, there should be no addback of expenditures corresponding with exempted dividends.

Alternatively, expenditure corresponding with exempted dividends could be measured as a fixed percentage of the dividend amount, for example, in line with the Parent-Subsidiary Directive 5% of the excluded dividend could be deemed as a non-deductible expense.

e. Allocation of "cross-jurisdictional" taxes (particularly, anti-avoidance rule). [*Refers to paragraph 284 of the Blueprint*]

1. Do you have any views on how to allocate the "cross-jurisdictional" taxes (e.g. CFC regime taxes and withholding taxes)? In your response please also consider the following:

ii. How can these issues be addressed in the design of a rule that minimises compliance and administration costs?

It would be helpful to explicitly recognise that there are tax consolidation groups and that payments to the tax authority can be made by a single group entity. Therefore it would be helpful if the rules were explicit that CFC taxes charged may actually be paid by other group entities in the parent jurisdiction who were not the direct parent. Whilst the jurisdictional level rules allow for aggregation of losses brought forward, the CFC inclusion can give a mismatch. For example, if a foreign reinsurer is taxable in the US under subpart F, there may be no covered tax for the CFC jurisdiction if overall the parent has losses in the year, noting that the subpart F inclusion will have reduced the tax losses carried forward in the US. Similar outcomes could result due to tax consolidation / group relief in the parent jurisdiction, resulting in the tax charge utilising losses in other entities. The rules should therefore explicitly allow offset in the CFC jurisdictional ETR numerator to reflect the utilisation of losses of relevant entities in the parent jurisdiction.

IV. Chapter 4: Carry-forwards and carve-out

a. Treatment of pre-GloBE losses and excess taxes under the carry-forward approach. [*Refers to paragraphs 315-318 of the Blueprint*]

4. Are there special considerations that apply to certain industries?

GFIA has noted above comments on the long-term nature of insurance and the importance of not limiting measures to short time periods unduly disadvantaging industries which operate over the long-term.

b. Formulaic substance-based carve-out. [*Refers to paragraph 332-370 of the Blueprint*]

1. Do you have any comments on the overall design of the carve-out?

The Pillar Two Blueprint proposes a carve out from the GloBE tax base in the form of a fixed return derived from payroll and tangible asset components. This formulaic carve-out has the effect of allowing routine returns to be excluded for both labor-intensive and fixed/tangible asset-intensive businesses.

Financial services companies – particularly insurance companies – operate around the globe under the careful oversight of regulators, which require specific and quantifiable amounts of capital be held in specific entities to ensure the protection of policyholders. The allocation of capital follows that allocation of risk – as noted above, regulators require specific amounts of capital in specific entities to support that allocation of risk. That is, there are objective measures of how much capital is required to be in the jurisdiction. Regulated financial services companies can decide where most efficiently to pool risks, but once the location of risk is determined it is difficult to move.

Similarly, a non-financial services company can decide where to locate a factory. A non-financial services company may choose to locate a factory in a low-tax jurisdiction. That decision does not and should not impact the application of the formulaic economic substance exemption. GFIA also draws the distinction between regulated insurance companies and group treasury companies which have far more fungible capital than insurers.

GFIA supports an economic substance exemption for financial services companies that reflects the realities of their business model – and therefore is based on regulatory capital.

As provided above, the carve-out in the Blueprint is only appropriate for labor-intensive and tangible asset-intensive businesses, and therefore provides little benefit to industries which require and are constrained by capital.

c. Computation of the ETR and top-up tax. [*Refers to paragraph 371-375 of the Blueprint*]

1. Do you have any comments on the proposed calculation of ETR and top-up tax?

GFIA has commented above on concerns on the complexity of the calculations required in Section 3A.

V. Chapter 5: Simplification options.

a. General. The Blueprint describes four potential simplification measures, including (i) CbC Report ETR safe harbour, (ii) de minimis profit exclusion, (iii) single jurisdictional ETR calculation to cover several years, and (iv) tax administrative guidance.

3. Can you identify any other overall simplification measures that could be explored by the Inclusive Framework or potential simplifications to the design or application of specific elements of the IIR or the UTPR that would not undermine their objective or effectiveness?

While GFIA acknowledges the policy objectives underlying many of the design features of the GloBE rules, the provisions remain far-reaching and complex, presenting significant implementation and ongoing compliance issues for MNEs. Accordingly, GFIA is supportive of the following:

Consolidated revenue threshold

GFIA supports a single consolidated revenue threshold of €750 million for purposes of applying the GloBE provisions. GFIA is not supportive of jurisdictions introducing an IIR that applies to groups with consolidated revenue of less than €750 million. Many MNEs will struggle to aggregate the necessary data and perform the relevant analysis to apply the GloBE provisions, and GFIA would anticipate that these challenges will be particularly acute for smaller groups. While even larger MNEs have expressed concerns regarding the administrability of the GloBE rules, these concerns are mitigated by efforts to ensure that these provisions represent a multilateral solution, consistently applied on a global basis. The introduction of jurisdictional optionality regarding a lower IIR revenue threshold creates additional uncertainty and complexity, while making it more difficult to coordinate the global application of these provisions and setting a concerning precedent for potential departures from a multilateral approach.

Approach to blending

The focus on a jurisdictional blending approach is a significant contributing factor to the complexity and administrative burden associated with the proposed GloBE rules. GFIA is of the view that global blending provides a more appropriate balance between the policy objectives of the GloBE provisions and overall administrability of such provisions and continue to support global blending as the preferable alternative to jurisdictional blending. The deference and acknowledgement to GILTI support alignment with global blending as the international standard.

GFIA acknowledges the OECD preference for a jurisdictional basis, but advocate that using a global calculation as a safe harbour (e.g. at a higher rate than the GloBE minimum) could provide a welcome simplification and remove the costly compliance complexity for many groups operating predominantly in high tax jurisdictions.

In addition, using consolidated accounting materiality would achieve consistency of accounting rules and remove the need to resort to entity level financial information for unconsolidated subsidiaries with potentially different accounting standards.

b. CbC Report ETR Safe Harbour. [*Refers to paragraphs 381-390 of the Blueprint*]

2. Do any of the required adjustments, as described in the Blueprint, create significant additional complexity? Do you have any suggestions on how to streamline these required adjustments?

Alignment of Pillar Two filing and tax payments with CbC timescales will be required where the CbC report is used as an input into Pillar Two calculations.

3. Do you support the idea of using deferred tax accounting to provide a more accurate picture of the MNE's expected tax liability in each jurisdiction without the burden of computing and tracking carry-forwards? Would doing so add material complexity?

As explained above in section 1, GFIA takes the view that a mechanism based upon deferred tax accounting can address many of the deficiencies that arise in the current proposed GloBE rules. A deferred tax approach is likely to be less distortive and rely on information already calculated so administratively more simple to operate. To the extent deferred tax accounting is not adopted, then the systemic and material timing items unique to the insurance industry that are explained above need to be taken into account as adjustments in the GloBE rules.

c. De minimis profit exclusion. [*Refers to paragraphs 391-398 of the Blueprint*]

2. Do you have suggestions as to how this determination could be streamlined, for example by using 'Profit (Loss) before Income Tax' as reported in the CbC report?

GFIA is of the view that simplification is required as the compliance burden of the full application of Pillar Two will be very high, including for territories where no Top-Up will be levied. The Pillar Two principles are explicitly based on CbC principles. GFIA therefore supports the use of existing CbC numbers as a gateway to exclude those territories where no Top-Up will be levied and allow the full Pillar Two measures to be targeted appropriately.

5. In order to be effective, how should the de minimis threshold be set? Should it be a percentage of group profit, a fixed monetary amount threshold, or a combination of the two?

The de minimis profit exclusion rule should work as a relative threshold based on the global profit of the MNE. The 2.5% proposed rate in the Blueprint enables MNEs to exclude entities that would normally not be taken into account in the consolidated financial statements.

VI. Chapter 6: Income Inclusion and Switch-over rules

c. Split-ownership. [*Refers to paragraphs 434-452 of the Blueprint*]

1. Do you have comments on the design of the proposed split-ownership rules?

In case of split ownership, GFIA understands that under the GloBE rules MNEs may be subject to multiple IIR liabilities, concerning the UPE and partially-owned intermediate parents. This would only increase the administrative and compliance costs of implementing Pillar Two. It would therefore be far easier if any IIR liability provided for under GloBE rules were dealt with by the UPE only.

VII. Chapter 7: Undertaxed payments rule

b. Compliance and administration. [*Refers to paragraphs 526-537 of the Blueprint*]

2. Are there ways in which these can be improved to further streamline the compliance burden on MNEs?

See comments on timing differences above in Section 1.

IX. Chapter 9: Subject to tax rule

a. Covered payments and low-return exclusion. [*Refers to paragraphs 588-616 of the Blueprint*]

1. Do you consider that the categories of covered payments and the exclusion for low-return payments ensures that the STTR focuses on the transactions that present significant BEPS risks?

See detailed comments on the subject to tax rule above in Section 2.

X. Chapter 10: Implementation and rule co-ordination

a. Effective co-ordination of the GloBE rules. [*Refers to paragraphs 697-708 of the Blueprint*]

1. Are there any co-ordination mechanisms or other features of the GloBE that you would suggest exploring in order to provide for more tax certainty in applying the Pillar Two rules?

Due to the complex rules under Pillar Two there will be an inevitable increase in compliance burden for companies as well as tax authorities. To offset at least part of the additional compliance burden, the introduction of the rules should be accompanied with a cut back of existing anti-abuse rules with similar policy objectives. The envisioned rules already secure an effective minimum taxation of the (global) income of companies which are in scope of Pillar Two. Due to the applicable minimum taxation as well as the increased compliance burden it should be considered to exempt in-scope companies from comparable national anti-abuse rules. Otherwise the simultaneous application of national anti-abuse rules (e.g. CFC, UK diverted profits tax) and the GloBE rules/STTR may result in double taxation as well as unnecessary bureaucratic expenditures.

b. Dispute prevention and resolution. [*Refers to paragraphs 709-715 of the Blueprint*]

1. In addition to the design features and proposed approach to implementation of the IIR and UTPR, what additional options do you think should be considered to minimise the scope for double taxation and dispute?

GFIA supports the development of a multilateral convention introducing provisions for dispute prevention and resolution as regards the implementation of GloBE rules, as well as provisions for the exchange of information between tax administrations

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About GFIA

Through its 41 member associations and 1 observer association, the Global Federation of Insurance Associations (GFIA) represents the interests of insurers and reinsurers in 64 countries. These companies account for around 89% of total insurance premiums worldwide. GFIA is incorporated in Switzerland and its secretariat is based in Brussels.