

GFIA response to OECD consultation on the Global Anti-Base Erosion (GloBE) Proposal under Pillar Two

Overview

GFIA notes that the Public consultation document on the Global Anti-Base Erosion (GloBE) Proposal (“consultation document”) welcomes comments on all aspects of the Programme of Work on Pillar 2, but only provides detailed consideration of some aspects of the GloBE proposal. This not only makes a response to the overall design of the GloBE proposal difficult, but also leaves many unanswered questions in terms of the three issues that are considered in the consultation document.

Rule co-ordination is an important aspect which is not discussed in the consultation document. GFIA has concerns as to how the four component parts of the GloBE proposal outlined in the Programme of Work would be co-ordinated or ordered and this also impacts GFIA’s ability to comment fully on the consultation document.

In this context, GFIA has responded where it can, to the request for comments on other aspects of the OECD Programme of Work on Pillar 2. However, given GFIA’s concerns, general comments are primarily provided under the headings of the three technical design aspects:

- the use of financial accounts as a starting point for determining the tax base under the GloBE proposal as well as different mechanisms to address timing differences;
- the level of blending under the GloBE proposal and the extent to which an MNE can combine high-tax and low-tax income from different sources taking into account the relevant taxes on such income in determining the effective (blended) tax rate on such income; and
- stakeholders’ experience with, and views on, carve-outs and thresholds that may be considered as part of the GloBE proposal.

Summary

GFIA notes that the proposals in the Programme of Work and consultation document will lead to greater operational complexity and will have a significant impact on the insurance industry. However, given the information that GFIA has to date GFIA considers that:

1. Global consolidated financial accounts are likely to be the most appropriate starting point.
2. The deferred tax accounting approach to capturing temporary differences is likely to be the most appropriate approach, however this approach will require careful application and some adjustments to avoid unfair outcomes.
3. Worldwide blending is the most practical approach to an income inclusion rule, this is particularly the case where global consolidated financial accounts are the starting point.
4. If the final outcome of work on Pillar 2 leads to approved regimes (such as US GILTI or other similar minimum tax regimes), they should satisfy the income inclusion rule.

5. It will be critical that the ordering and interaction of the income inclusion rule with any undertaxed payments rule or other base erosion rule is carefully documented and fully considered.
6. Effective dispute prevention and resolution should be included in the GloBE proposal.

GFIA would welcome the chance to discuss these points in more detail, particularly once the Inclusive Framework has made more policy choices and agreed more of the technical and design aspects of the GloBE proposal.

Use of financial accounts to determine the tax base

GFIA is of the view that group consolidated financial statements are likely to be the most appropriate starting point. The minimum acceptable frameworks are likely to be US GAAP and IFRS, but where another national GAAP is used by the ultimate parent company for preparing its consolidated financial statements, this should be acceptable. GFIA does not consider there is a high risk of accounting framework arbitrage for a number of reasons:

- External commercial and regulatory factors are likely to be more significant than any tax drivers.
- Accounting frameworks are subject to regular updates/improvement programmes. Over time, the relevant frameworks are likely to converge and limit the expected long-term benefit of any arbitrage.

The income determined from consolidated accounts after agreed adjustments would seem to be the appropriate denominator for the effective tax rate fraction on page 9/10 of the consultation document. Regarding the numerator in the effective tax rate fraction, GFIA considers that this should include all relevant taxes, including profit based and withholding taxes and gross basis taxes such as U.S. Federal Excise Tax and premium taxes that are levied on the insurance transaction. The IAS 12 definition could be used to ensure relevant state/regional taxes and withholding taxes on cross-border interest/dividend payments were correctly included to show the true overall tax burden imposed.

Adjustments

Dividends and capital gains/losses

A lot of jurisdictions do not tax certain profits /losses which have already been taken into account at a different level/entity essentially to avoid double taxation of profits/losses. Most jurisdictions do not tax capital gains/losses in connection with affiliated entities fulfilling certain criteria (often called participation exemption rules) and there are widespread dividend exemptions.

Taking the avoidance of double taxation as fundamental principle GFIA would recommend reducing the tax basis for these items.

FX and translation differences

As FX and translation differences (including functional currency) reflected in group accounts do not reflect economic gains / losses on trading activities, and often occur only on consolidation rather than reflecting local profits or losses these should be excluded from any calculation.

Investment tax credits

Additional tax credits available under many tax regimes should be excluded from the tax base. Where investment credits including R&D regimes operate, these are generally predicated on substance and local economic activity.

Deferred tax and temporary differences

One of the possible approaches to addressing temporary differences is to use deferred tax accounting as the basis of identifying the effective tax rate applied. The deferred tax approach is the least-worst approach but even this approach needs to be carefully considered, with due regard to industry issues. The other alternatives do not deal well with differences that arise over the longer term. A multi-year blending may not reflect the creation or reversal of the difference appropriately. Carry-forward of excess taxes/attributes will create an overly complex compliance burden. This could also result in blending of permanent and temporary differences, blunting the policy intent.

Insurance is particularly exposed to large long-term timing differences

Insurance groups will often have temporary differences that impact over the long term. Some of these reflect the business model across the insurance industry, while some others reflect the long-term nature of insurance contracts. For example:

- Insurers are often taxed either on local GAAP principles or based on regulatory returns that reflect local capital requirements. These may require larger technical provisions than included in consolidated accounts.
- Tax base / accounting base of investments can often differ (Fair Value vs amortised cost) and due to the significant amounts of investments held, this could be a big issue for insurers.
- The value in-force ('VIF') of acquired life business may be recognized on the group balance sheet but not individual company balance sheets

Deferred tax is not a magic bullet

- The operation of deferred tax rules is complex and framework dependent (for example US GAAP and IFRS have differing requirements and exemptions with respect to initial recognition exemptions and 'grossing up').
- Material distortions could arise due to consolidation adjustments (e.g. intangibles/VIF) recognized in group consolidated accounts but not included in local accounting/tax bases.
- Deferred tax asset recoverability / valuation allowances would distort the use of deferred tax to provide a proxy for a smoothed ETR. GFIA therefore recommends that if the deferred tax route is taken, this must be adjusted to remove recoverability/valuation allowance issues to ensure a fair comparison.
- There will be additional complexity where there are different types of tax gains/losses (e.g. the difference between trading and capital gains/losses) which will need to be addressed.
- Complexities could arise in deferred tax calculations including instances where a Pillar 2 calculation could become iterative, without making a material difference to the overall deferred tax position. Such complexities should be avoided.

Deferred tax rate change adjustments

Changes to local tax rates could impact upon the carrying value of deferred tax attributes which could come through as permanent rather than temporary differences. As these do not reflect the economic result of the group, tax charges/credits arising from these revaluations should be excluded from the tax base. This is likely to be a

significant issue for insurers due to the relative size of deferred tax balances commonly held on the balance sheet (as noted below).

Current / deferred tax relating to non-current periods

Where tax charges are recognised within in a period but relate to a different (earlier or even potentially later) period, they should be excluded as they could distort the effective tax rate. Mechanisms to smooth the effective tax rate over a number of years could address this issue but are likely to be administratively complex and could have distortive impacts (for example inclusion of permanent differences).

Blending

A worldwide blending approach is likely to be the most practical way of introducing an income inclusion rule. Entity or jurisdictional approaches would be very difficult. As the OECD itself states in the consultation paper, a blending at entity or jurisdictional level would lead to an enormous complexity for both taxpayers and tax administrators.

Should an entity or jurisdictional blending approach be used, it may create a regime that conflicts with business models and in some cases with regulatory rules. It could create double taxation due to timing and other differences that arise in domestic tax law compared to the tax law of the home country. A number of industries are subject to cyclical fluctuations that may produce variations in any country's effective tax rate due to factors such as the timing of income, deductions, losses, and credits, etc. However, insurance companies are especially subject to significant losses due to major natural disasters or other catastrophes. If an entity or jurisdictional approach was used, it would be necessary to introduce a multi-year (minimum 5 years) averaging to avoid anomalous results.

Similarly, withholding taxes on dividends (and credits or exemptions for dividends received which have been subjected to tax at lower levels) may also complicate the calculation of the effective tax rate on a per-country basis. Finally, there would need to be some recognition that lower returns on tax exempt securities are accepted in return for the exemption and without adjustment could distort the effective tax rate.

The resulting differences would be even greater in the insurance industry due to the different ways in which insurance reserves and other insurance specific features are accounted for by different countries and the upcoming introduction of IFRS 17 will bring new changes in the way in which many insurance groups account for insurance contracts.

In addition:

- Group financial statements are not generally built up at the appropriate granularity to enable entity or jurisdictional amounts to be identified with enough precision.
- Global blending will help eliminate issues associated with allocating expenses to various tiers of organisations
- On materiality grounds elements of deferred tax are often ignored at group reporting level. However, where an entity or jurisdictional approach was taken this would need to be resolved. Issues result in significant judgements being required around how deferred tax attributes will reverse, and consequential impacts upon double tax relief.

Carve outs

It is important that the GloBE proposal leads to a mechanism which ensures the fair treatment of MNEs regardless of the accounting standards used and existing local tax provisions with a similar objective. As long as this principle is not compromised, carve-outs should be considered for MNEs subject to an existing approved regime such as GILTI or European Controlled Foreign Company (CFC) rules.

Any entities subject to such an approved regime should be deemed to satisfy the GloBE minimum tax income inclusion if the regime applies broadly to certain income generated by a CFC, resulting in an effective minimum tax already being paid. This is the case for the US GILTI and for CFC regimes that are structured appropriately, and these should therefore be approved regimes.

In addition, in order to avoid double taxation, entities should be subject to only a single minimum tax under the income inclusion rule with priority given to the minimum tax of the highest-tier entity in a jurisdiction with such a qualifying minimum tax regime.

Interaction with other Pillar 2 rules

The consultation document does not address the ordering and interaction of the income inclusion rule with any under taxed payment, switch-over or subject to tax rules. Without careful consideration and documentation of the accepted approach to dealing with this issue, there is a real risk of double taxation and/or differences in interpretation that require extended and expensive resolution procedures that create uncertainty for all parties involved. This would add unnecessary and economically damaging friction to legitimate international business operations. Accordingly, if a jurisdiction adopts Pillar 2, thereby subjecting companies operating in that jurisdiction to the income inclusion rule, the other Pillar 2 rules should not apply.

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About GFIA

Through its 40 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.