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Public consultation on the reports on the pillar 1 and pillar 2 blueprints

Dear Sir or Madam,

Thank you for the opportunity to comment on the consultation document „Reports on the Pillar 1 and Pillar 2 Blueprints“. The German Insurance Association (GDV – Gesamtverband der Deutschen Versicherungswirtschaft e.V.) is the federation of private insurers in Germany.

In our comments below, we will confine ourselves to aspects of pillar 2.
In section A., we give our views on some of the questions raised in the consultation paper. In section B. we provide additional feedback on issues which are not specifically addressed by the consultation but which we feel are pertinent. In particular, we outline our concerns revolving around financial accounting issues for purposes of pillar 2 scope and ETR computation.

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A. Feedback on questions regarding pillar 2 raised in the consultation paper

"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 75-82 of the Blueprint]*

1. Considering that the GloBE rules only protect the tax neutrality of investment funds that are at the top of an MNE Group's ownership chain, are there specific situations in which the GloBE rules do not adequately protect the tax neutrality of investment funds?

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?

Answer:
The rationale behind the tax neutrality of the investment funds is to put the investor in the same position as if they earned the income directly. This consequently requires that in the case of an investment fund controlled by a constituent entity located in a jurisdiction other than the investment fund the income of the investment fund is assigned to the controlling entity. The same applies for any taxes levied on the fund´s income incl. withholding taxes (e.g. on dividends received by the fund).

The allocation of the fund's income to the investor also avoids inequitable results in case of a life insurance. Many life insurers use investment funds 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 profit related to this investment income.

The situation may be such that the consolidated fund is located in a jurisdiction other than the investor´s jurisdiction. In such a scenario, the investment returns and the expense from the recognition of corresponding liabilities should be assigned to the same entity and consequently the same jurisdiction. To separate both could lead to unjustifiable results, i.e., exaggerated GloBE profits in the investment fund´s jurisdiction and artificially low GloBE profits or permanent losses in the jurisdiction of the investor.

One way to mitigate this issue would be to treat the fund's investment returns as arising in the investor's jurisdiction and excluding the income from the GloBE tax base calculation of the jurisdiction that the fund is resident in.

Furthermore, the definition of investment funds seems too narrow. The definition given in the blueprint could be understood as requiring more than one investor. For example, under German tax law investment funds with a sole investor also qualify as investment funds. Deviations between the local tax law definition and the pillar 2 definition of investment funds might lead to unintended overtaxation.

„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 188-189 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?"

Answer:
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 purpose of pillar 2 (see paragraph 185 of the OECD pillar 2 blueprint). Though from a systematic perspective such a corresponding rule might be comprehensible, from a practical perspective such a rule would be burdensome. Furthermore, we do 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, expenditures corresponding with exempted dividends could be measured as a fix percentage of the dividend amount, for example, in line with the Parent-Subsidiary Directive 5 % of the excluded dividend could be deemed as non-deductible expense.

"V. Chapter 5: Simplification options
b. CbC Report ETR Safe Harbour. [Refers to paragraphs 381-390 of the Blueprint

1. Does the requirement for using the parent's consolidated financial accounts significantly reduce the number of MNEs able to use this simplification measure?

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?

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?

4. Do you have ideas on how this simplification measure should be coordinated with the carry-forward mechanisms described in Blueprint? For example, in instances where the MNE has an ETR that is above the safe harbour ETR for one or more prior years, but one that is below the safe harbour ETR in the current year, should the MNE be allowed to go back and compute its carry-forward attributes for the prior years?

Answer:
We think that safe-harbour rules could be a proper simplification instrument. In most counties the ETR can be expected to be higher than the GloBE minimum tax rate. Nevertheless, without any safe-harbour rules companies would be required to calculate the ETR for every jurisdiction they operate in. Companies may face substantial administrative burden even where it is certain that in a particular jurisdiction the ETR exceeds the GloBE minimum tax.

We think the most straightforward way for a safe-harbour rule would be to white-list low-risk jurisdictions.

Alternatively, MNE groups whose overall tax rate on the overall worldwide income outside the UPE´s jurisdiction exceeds a certain level could be excluded from the scope of the GloBE rules. We acknowledge 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.

If a white-list of low-risk jurisdictions or a global ETR escape is not available, we would welcome the idea of a simplified ETR computation (paragraphs 381-390). From our perspective a perceptible simplification could only be achieved if the safe-harbour ETR calculation is substantially simplified.

„IX. Chapter 9: Subject to tax rule
a. Covered payments and low-return exclusion. *[Refers to paragraphs 617-620 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?“

Answer:
As outlined below, the Subject to Tax rule relating to insurance or reinsurance premium seems to disregard the economic realities in the insurance sector and would likely result in over-taxation.

1. **Differentiation in view of BEPS risks 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 legitimate business models in the insurance sector. The examples of captives mentioned by the OECD are not comparable to the business model of globally operating insurance companies. From a BEPS risk perspective, there should be made a distinction between a captive and a reinsurance entity of an insurance MNE group. A captive on the one hand typically provides insurance policies exclusively or almost exclusively for risks of entities of the MNE group to which it belongs. A reinsurance entity on the other hand provides reinsurance for risks of unrelated parties that are insured by other entities of the MNE 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 capital requirement which ensures that it has the financial capacity and the necessary personnel to assume risks from the insured customers. Substantial losses may occur at any time and are part of the course of business. Usually, besides providing intra group reinsurance to other group members, the reinsurer of an insurance MNE group has predominantly direct business with third party customers.

2. Transfer pricing comparables are available

It also follows from the foregoing that comparable uncontrolled prices are available from contractual arrangements with third party customers. The assumption in section 601 of the pillar 2 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 when it comes to reinsurance entities of insurance MNE groups.

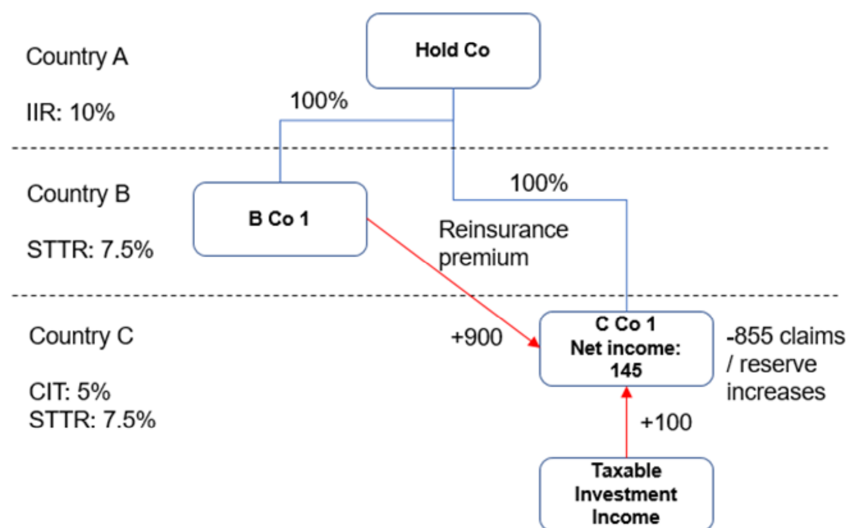
Furthemore, since the new chapter X of the OECD Transfer Pricing Guidelines with a chapter dedicated to captive insurance has been adopted, there are existing international transfer pricing rules which address low substance captive structures, effectively mitigating the risk of artificial BEPS resulting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

3. 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 particularly hit hard companies whose sole or main source of turnover was subject to withholding tax under the envisaged Subject to Tax rule, as would be the case for reinsurers of MNE groups. Over-taxation could be the result of the withholding tax if it were not to be creditable against the income tax of the payee as suggested by the Blueprint. 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 which can never be used.

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 overall is 145.
- 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.
- The 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% - 5.0%) STTR withholding (=22.5 tax) applies to the re-insurance 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%.

In the insurance sector, the illustrated example cannot be seen as a one-off event in a single year but rather as a more or less prevailing situation. Given the minimum tax rate of 10%, it is hard to see how the Subject to Tax rule in the circumstances can be aligned with the overall policy objective of pillar 2.

In effect, the Subject to tax rule would work as a turnover tax, possibly in addition to an insurance premium tax levied on the same payment. This could hardly be justified as a BEPS counter measure.

We understand that withholding taxes under the Subject to Tax rule would feed into the local tax carry forward. Because the local tax carry forward as foreseen by the Blueprint is limited in duration, the situation may occur that the withholding tax cannot be used to shield income from GloBE tax liability in a subsequent year.

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

The Subject to Tax rule would penalise internal (re)insurance structures of MNE Groups which are an essential means to achieve an allocation of capital and risk that meets the market requirements. Such structures are required to address requirements imposed by regulators worldwide, which seek to ensure an as-high-as-possible capital endowment of (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. The level of taxation is not the decisive factor for locating a re-insurance entity of an MNE group in a certain jurisdiction.

The withholding tax under the Subject to Tax rule would work as a disincentive for spreading insurance risks among group members, since it raises the costs for buying intra group re-insurance policies. The consequence may be the accumulation of insurance risks in countries that have introduced the Subject to Tax rule.

5. Subject to Tax Rule would make insurance policies more expensive

An additional tax on the payment of (re)insurance premiums would impose an additional cost of the (re)insurance product. It is in the fundamentals of (re)insurance business that fix and expected costs, including a claim, must be covered by premiums. Consequently, increasing fix cost elements to (re)insurance has a direct effect on the pricing of (re)insurance products.

It should further not be forgotten that the occurrence of insured risks is uncertain and it is in the nature of (re)insurance contracts that the insured risks may materialise resulting in an immense loss in one given year. The view taken in section 601 of the pillar 2 blueprint that (re-) insurance premiums can generate a high return seems to ignore that fact and takes the isolated view on just one single insurance contract in a period of time without claims.

6. Conclusion

Intra-group insurance and reinsurance premiums of MNE groups of the insurance sector should be removed from the scope of the STTR rule. Alternatively, over-taxation effects should be eliminated by allowing unusable local tax carry forwards resulting from STTR – withholding tax to be credited against income tax liabilities in the UPE jurisdiction.

B. Other pertinent issues

I. Scope of the GloBE rules

The GloBE rules introduce a new and complex international tax system. In particular in the beginning the coordination of taxing rights between various jurisdiction might not work as expected and companies could face double taxation as a consequence. The blueprint propposes a € 750 million annual gross revenue threshold for the application of the GloBE rules. We think that the threshhold should be higher, at least in the introduction phase. This way, experience gained in the introduction phase can be used to optimise procedures before possibly extending the scope at a later stage.

II. Compliance complexity

Due to the complex rules under pillar 2 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 2. Due to the applicable minimum taxation as well as the increased compliance burden it should be considered to exempt these in-scope companies from comparable national anti-abuse rules. Otherwise the simultaneous application of national anti-abuse rules and the GloBE rules/STTR may result in double taxation as well as unnecessary bureaucratic expenditures.

III. Recognition of national accounting standards (paragraph 173 of the pillar 2 Blueprint)

MNE with a consolidated group revenue threshold of at least € 750 million are in scope of the GloBE-rules under pillar 2. 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 € 750 million threshold, they are in scope of pillar 2.

We welcome 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 2 blueprint). In our view, the European accounting standards such as the German GAAP meet these criteria and should therefore be accepted.

IV. Definition of revenues

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 € 750 million revenue threshold which determines whether an MNE group is within scope.

Many long-term insurance products include an element of savings and investment assets. 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 € 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.

It is for this reason that revenues of insurance companies under German GAAP tend to be relatively high. (Banks on the other hand do not show customer deposits as revenues.) Metrics applied to insurance groups should therefore adequately reflect the specific nature of the business and exclude policyholder items.

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

V. Recognition of the long-term nature of insurance business

In the insurance sector, tax rules often follow rules for valuing investment assets and insurance technical provisions that differ from IFRS requirements (specifically after the new standard IFRS 17 Insurance Contracts gets effective starting from 1 January 2023). As these are the significant items on insurers' balance sheets this commonly leads to massive timing differences between tax and accounting.

These timing differences can be very long lasting. Many insurance policies extend over decades. This is common across life insurance, the long-term savings world (e.g. pensions and investment bonds) and general insurance (e.g. asbestos and other liability claims that arise decades after the associated premium payments). Regulatory reserves (such as equalization/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 so as to meet its long term promises to policyholders and their beneficiaries. In contrast, financial statement accounting is intended to provide investors a view of the company's profitability in the reporting period and to give investors a basis for comparison of products and companies. Under IFRS, for examples, equalisation reserves are not recognised, see IFRS 4.14(a). Tax rules often still follow the traditional regulatory basis of calculating insurance reserves. 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 equalizing results over time. The timing differences resulting from differences in the valuation rules for balance sheet provisions may take decades to reverse.

Particularly the limited duration of the the local tax carry-forward may potentially be in conflict with the long-term nature of insurance business. The duration should be long enough to cover temporary differences typically occurring in the insurance sector.

VI. Recognition of an unused IIR-Tax-Credit (see paragraph 309 of the OECD pillar 2 Blueprint)

We welcome the discussion within the Inclusive Framework on the question 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 lacking a top-up tax under pillar 2 in succeeding years. The situation can arise after a raise of the tax rate in a formerly low taxing jurisdiction.

Yours faithfully,

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