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Position Paper

of the German Insurance Association (GDV)
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on the proposal for a directive on ensuring a global minimum level of taxation for multinational groups in the EU

1. Timeline for the transposition of the rules

From 1 January 2023, insurance companies will need to implement IFRS 17 and IFRS 9. The implementation will lead to changes in accounting, further analysis and still uncertain outcomes as to which available options within the new standards to apply.

Given the complexity of the rules proposed in the Directive and their impact on compliance, the measures should take effect not before 2024 and therefore an extension of the implementation deadline would be advisable. If appropriate measures aren't taken, insurers would like to stress that there would be the risk that companies may not be ready to properly determine the tax liability arising from the top-up tax (if any) when they have to prepare their financial reports for Q1 2023.

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2. Simplifications

Due to the considerable compliance effort for companies both at the time of introduction of the new rules and afterwards, simplifications are necessary, such as “safe harbour rules” for high-tax jurisdictions.

3. Definition of insurance investment funds

The definition of insurance investment funds does not reflect the reality of insurance business.

The “wholly-owned“ requirement raises the question of whether a fund whose participations are held by different entities within one group may be seen as an insurance investment fund. Furthermore, the requirement that the fund is established “in relation to liabilities under an insurance or annuity contract” should be interpreted as including investments not only for life insurance but for any type of insurance contracts.

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4. Treatment of investment funds

Another concern is the fact that beneficial domestic tax treatment of investment funds would trigger top-up tax due to the limited scope of the elections provided by Art. 40 (7.5 of OECD Model Rules) and 41 (7.6 of OECD Model Rules). Usually, under domestic tax law, investment funds are exempt from tax in order to ensure a single layer of tax on income that an investor derives through an investment fund. Such tax exemption is consistent with the Global Anti-Base Erosion (GloBE) rules (see par. 79 of the Pillar Two blueprint report). Consequently, GloBE rules should not trigger top-up tax on the income of an investment fund. The envisioned rules do not achieve this goal and could result in an unintended top-up tax.

Both elections essentially aim to attribute the income of an investment fund to the investor, where it is then subject to an effective tax rate (ETR) computation. In circumstances where investment income is taxed at the level of the investor, the ETR computation would produce adequate results.

However, in many instances, neither election is available.

Firstly, the tax transparency election under Article 40 has a very narrow scope. According to Art. 40, investment funds may be treated as transparent for ETR purposes. The election is available for an investment entity or an insurance investment entity, provided that the constituent owner is subject to tax in its location under a regime based on the taxation of the annual changes in the fair value of its ownership interests in the entity. In Germany as in other countries, changes in the fair value of the ownership interest in the investment entities are not taxed. Therefore, this election may not be used in these jurisdictions. Thus, we request a widening of the scope for Art. 40 so that German investors may avail themselves of the election.

Secondly, the taxable distribution method election according to Art. 41 also has a narrow scope. Under this election the fund´s distributions or deemed distributions are included in the ETR calculation of the investor. The scope is prohibitively restrictive for two reasons:

The current wording limits the election to an investment entity. Insurance investment entities are excluded. The reason why insurance investment entities are excluded from the provisions of Art. 41, while being included in those under Art. 40 is unclear. We consider it imperative that insurance investment entities are included in the scope of Art. 41.

Furthermore, the requirement in Art. 41 par. 2 whereby the funds' (deemed) distributions must be subject to a minimum tax rate of 15 % leads to conflicts with domestic tax laws. The requirement seems to presuppose that investment income is only taxed when it is distributed by the fund. However, this is not always the case. In some jurisdictions, the design of a domestic tax system may ensure tax neutrality of a fund by taxing investment income at the level of the fund but exempting such income from tax when it is distributed or deemed to be distributed. According to German investment tax law, distributions made by a fund are partially tax free in order to avoid a second layer of taxation on the same income. In a scenario like this, the election cannot be used simply because the 15 % minimum tax rate requirement only takes into account the tax on (deemed) distributions. Therefore, the requirement should be amended to account for tax regimes which tax-exempt distributions by an investment fund.

Also, tax incurred by the fund cannot be used as covered taxes since, according to Art. 41 par. 2, the funds' taxes are excluded from all ETR computations. In other words, whereas the income of the fund (provided it is distributed or deemed to be distributed) is attributed to the investor, the tax incurred by the fund is not, thus separating income and the corresponding tax for ETR purposes. As a consequence, under the rules of Art. 41 a top-up tax is likely to be triggered where the investor is resident in a jurisdiction that exempts (deemed) distributions in order to achieve the tax neutrality of the fund. Again, similar to the conclusion regarding Art. 41 par. 1, the provisions in Art. 41 par. 2 should be amended or interpreted so that tax incurred by the fund may be included in the adjusted covered taxes amount of the investor.

Finally, the period until the income of the fund has to be distributed should not be strictly limited to three years, as it may run counter to the tax policies of jurisdictions with regard to undistributed income. For example, Germany leaves certain items of undistributed income by investment funds untaxed for a 15-year period.

5. Deferred taxes

Insurers believe that a fundamental policy concept of Pillar Two is to look at ETR over a period of time to neutralise the consequences stemming from application of the annual accounting concept. Having to recast deferred taxes at the minimum rate does not appear to be justified. The requirement that deferred tax balances be recast at the minimum rate undermines the ability of the rules to achieve the policy objective of smoothing the ETR noted immediately above. Recasting deferred tax amounts at the minimum rate does not provide recognition of the actual rate of tax that will be borne in respect of the relevant underlying timing difference when looking at the annual ETR and will result in top-up tax both in respect of timing and permanent differences. This consequence will arise notwithstanding that the true ETR borne by the multinational enterprise (MNE) over time is higher than the minimum rate. For example, top-up tax will arise in circumstances where there are loss carry-back rules under local legislation or where tax losses are being utilised and there is a permanent difference, regardless of the materiality of that permanent difference or its impact on the effective tax rate, and regardless of the level of tax paid by an MNE over time. The outcome of this calculation is double taxation.

Regarding the deferred taxes, we also have serious concerns with the level of aggregation. In financial statements, the deferred taxes are computed on an aggregate basis. The data required for a calculation of the deferred taxes based on each and every individual asset/liability is simply not available. The gathering of this information would be tremendously burdensome. Therefore, we strongly recommend computing deferred taxes on an aggregate basis.

Also, for insurance companies it is important that contingency reserves (safety reserves) get the same treatment as other insurance reserves and that should be made clear in the directive. Due to the insurance business model, insurance companies have to make assumptions about the future. Contingency reserves are a legitimate way for insurance companies to cater for factors that are random or otherwise difficult to assess.

6. Calculation of ETR

With regards to the proposal to calculate the ETR position on a yearly basis without compensation over the years, the general basic assumption in financial and tax accounting is that taxes payable should, over the lifetime of a company, be based on the total profit concept, being the sum of all yearly profits. To meet this basic principle, the introduction of a carry forward or averaging instrument would be appropriate. One could think of a recalculation of the five-year average of the ETRs in a country with the potential of a refund.

In addition, to alleviate the burden of having to perform ETR recalculations, the materiality threshold of €1 million in Art. 24 should be raised.

7. Restricted tier 1 capital (RT 1)

Under Solvency II regulations, insurers can issue restricted tier 1 capital (RT1). This is contingent convertible subordinated debt and includes a contractual trigger to convert to equity when specified events occur. In some countries, RT1 is treated as equity for accounting purposes, but coupons are deductible for tax.

This treatment is identical to additional tier 1 capital in the banking sector. Given the similarity between RT1 and additional tier 1 capital, it should be clarified that Art. 15 par. 11 is also applicable to the insurance sector. Without this alignment, the EU Directive would negatively impact insurers' efficient access to capital markets.

8. Consolidation scope

According to 1.2.2. (b) of the OECD Model Rules and Art. 3 par. 3 lit. a of the Directive, the MNE group definition for Pillar Two also includes related entities which are excluded from the consolidated financial statements of the ultimate parent entity based solely on size. Currently, these insignificant related entities are often not connected to the reporting infrastructure and the accounting standard used for the entity regularly deviates from IFRS or another accounting standard used in the preparation of the consolidated financial statements of the ultimate parent entity. For that reason, the data required for the ETR computation is not easily available and a translation of the financial statements under local GAAP for these entities would be necessary.

The exclusion of insignificant related entities from the consolidated financial statements of the ultimate parent entity follows the materiality principle. Given the policy rationale of Pillar Two to limit the scope of the global minimum tax to large multinational companies, it seems contradictory to include insignificant entities. Due to their small size, a possible minimum tax for these entities would be marginal and disproportionate to the resulting administrative burden.

9. Top-up tax double charge

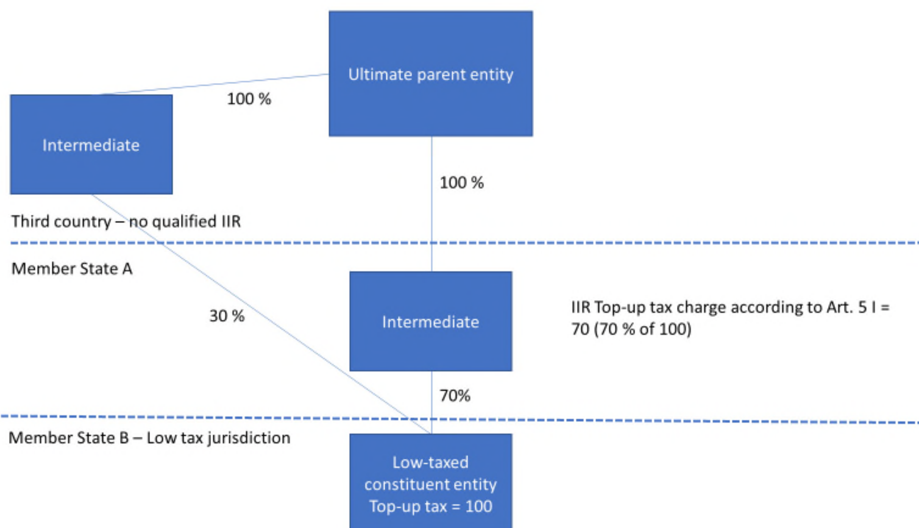
Under the concept of the GloBE rules, the undertaxed payment rule (UTPR) is meant to operate as a secondary mechanism. Top-up tax is caught by the UTPR where it is not already brought into charge under the primary income inclusion rule (IIR). To this end, Art. 13 par. 3 and 4 of the draft contain provisions whereby UTPR top-up tax is reduced where same top-up tax is already subject to a qualified IIR. However, the reduction rules are

in some circumstances disfunctional and not line with the OECD model rules.

Art. 13 par. 3 is meant to turn off the UTPR where the allocable share of the ultimate parent entity in the top-up tax is brought into charge under an IIR either at the level of the ultimate parent entity or further below in the ownership chain. However, the current wording of Art. 13 par. 3 („… such low-taxed constituent entity is wholly held…“) implies that it is only applicable to 100 % holdings. This is not in line with par. 2.5.2 of the OECD model rules. The requirement in par. 2.5.2. whereby all of the ownership interests in the low-taxed constituent entity are held by the ultimate or an intermediate parent entity does not entail that the ownership interest amounts to 100 %. Instead, the UTPR is also turned off in cases of smaller holdings.

Furthermore, the current wording of Art. 13 par. 4 is not in line with par. 2.5.3. of the OECD model rules. The reduction is only applicable if top-up tax is allocated to a parent entity in a third country jurisdiction with an IIR in place but not if the parent entity is located in a Member State.

This may be illustrated with the following example.



In the example, top-up tax of 100 arising from the low-taxed constituent entity is brought into charge under the IIR in Member State A at a ratio of 70 %. One would expect that only the remaining 30 top-up tax would be subject to an UTPR. Instead, under Art. 13 of the draft directive, the full amount of the top-up tax would be subject to UTPR top-up tax, leading to double charging of 70 which is already subject to an IIR. Neither the reduction under par. 3 nor 4 of Art. 13 is applicable.

10. Income allocation to a flow-through entity in case of external entity-owners

Art 18 par 1 (b) is not in line with par. 3.5.3. of the OECD model rules. The provision is an exception to the rule that income of a flow-through entity (e.g. a partnership) is reduced insofar as it is allocable to entity owners outside the group. It is supposed to be applicable to a flow-through entity which is held by an ultimate parent entity that is itself a flow-through entity. The current wording is too far reaching as it applies to any situation where the flow-through entity is held by any ultimate parent entity even if its holding is less than 100 %. This would contradict par. 3.5.3. of the OECD model rules whereby the income of a flow-through entity is reduced where entity owners outside the group exist. It appears that the word "such" before the phrase "an ultimate parent entity" should be inserted in line with the wording of 3.5.4. of the OECD model rules.

11. Domestic top-up tax

The GloBE rules are very complex and will bring about considerable compliance burden. The envisaged domestic top-up tax will complicate things even further. We understand that the rule is meant to allow Member States to benefit from the top-up tax revenues collected on their low-taxed constituent entities located in their territory. However, Member States may achieve the same objective by raising their corporate taxes. This option would also open the possibility to whitelist those jurisdictions for purposes of administrative guidance simplification measures. Therefore, the advantage of introducing a domestic top-up tax seems outweighed by the disadvantages in terms of compliance and advantages in terms of simplification potential.

12. Application of penalties

Pillar Two introduces a wholly new taxation regime. The complexity of the rules and the short timeline for the development of the commentary and the implementation framework, as well as the legislative processes make it difficult for the companies to implement the rules and have all the necessary know-how and processes in place when the rules enter into force. The filing of the top-up tax information return not only demands the gathering of data from entities all over the world but also requires additional accounting for the purposes of Pillar Two.

Against this background insurers believe that companies should not be subjected to administrative penalties in the early stage of the implementation phase. This would recognise the fact that the implementation and filing in the first years after the new rules come into effect cannot be "perfect" in each and every case and detail. Therefore, the penalty rules envisioned in Art. 44 of the directive should be amended so that in the first three years after the entry into force, delays and mistakes in the top-up tax filing will not lead to a penalty.

Furthermore, we believe that the intended penalty of 5 % of the turnover irrespective of the amount of top-up tax would be disproportionate. Under the current wording, the penalty could be charged for late filing even where no top-up tax is eventually applied. Rather than a percentage of the turnover, the penalty should be based on a percentage of the top-up tax. In addition, the penalty should be designed as a maximum penalty and should only be applied in the case of false declaration if this was done intentionally.

13. Review period

Given the complexity of the directive and the various open questions and the need to adapt to future developments, we believe that Member States should be able to revise the rules, especially after an implementation phase. To this end, the directive should be time-limited, for instance through a sunset clause whereby all or a set of provisions in the directive cease to have effect after a certain period (e.g. 2 years). This would allow for fine-tuning and further simplification adjustments of the Pillar Two rules.

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