Position Paper

Insurance Europe comments on the European Commission's corporate taxation (anti-tax avoidance) initiatives

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General comments

The insurance sector supports European policymakers' objective to tackle tax avoidance and abusive tax practices and create a level playing field for all businesses.

Insurance Europe believes that the outcome of the Organisation for Economic Cooperation and Development's (OECD) base erosion and profit shifting (BEPS) Action Plan should be implemented in the European Union in a coordinated fashion through the Anti-Tax Avoidance (ATA) Directive, to avoid unilateral differentiation between member states. Any additional requirements that go beyond the OECD's recommendations would not necessarily combat aggressive tax planning, harmful tax regimes and tax fraud, but may potentially harm the competitiveness of the EU. Insurance Europe believes that such measures should therefore be subject to a due assessment of their impact.

In addition, the EU proposals should be in line with the OECD outcomes which will be implemented in other (non-EU) jurisdictions, to ensure that there is consistency in the scope and timing of proposed measures. A competitive disadvantage would otherwise exist compared to non-EU jurisdictions; this would penalise European companies and be harmful for future investments in the EU.

In the context of the proposal for an anti-tax avoidance directive and of the foreseen re-launch of the Common Consolidated Corporate Tax Base in November 2016, Insurance Europe would like to take this opportunity to comment on a number of outstanding issues which are of great importance to the insurance sector. These relate in particular to the treatment of hybrid regulatory capital and rules for controlled foreign companies.

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Specific comments

Definitions

The ATA Directive defines "financial undertaking" in Article 2(4). Insurance Europe believes that this definition should be further clarified with respect to the following aspects:

- In the case of groups, should the definition be applied at group level on the basis of the commercial consolidated accounts? Alternatively, should the definition be applied to each individual entity of the group?
- How should the definition apply to a fiscally-consolidated group which includes both financial and non-financial undertakings?
- Do non-EU regulated entities qualify as financial undertakings under this definition?

Insurance Europe believes that the accurate definition of "financial undertaking" is of crucial importance given that the term is used throughout the text of the proposed Directive. When the text states, for example, that CFC rules "shall not apply to financial undertakings", it should be very clear which entities are exempted. As an example, article 212 of the Solvency II Directive, which deals with the supervision of insurance undertakings in a financial group provides good definitions for such situations.

The terms in Article 2(1-3) have been defined properly and these definitions should be same for expense and income items. What is unclear is how activities such as lease, factoring, commodity, finance and securitisation will be treated.

The treatment of hybrid regulatory capital

- Hybrid regulatory capital is not designed to create tax mismatches and its use does not constitute a harmful tax practice. This type of capital is very useful to insurers, for regulatory and commercial reasons. Therefore, hybrid regulatory capital should be exempted from any additional tax burden.

Action 2 of the BEPS Action Plan made proposals to neutralise the effects of hybrid mismatch arrangements, based on the OECD's concern that some hybrid instruments can lead to base erosion. The European Commission included hybrid mismatch provisions in the anti-tax avoidance package and is considering which rules for hybrids to include in the re-launch of the CCCTB in November 2016. In this context, the Commission is explicitly considering the treatment of hybrid regulatory capital.

Insurance Europe believes that any proposed rules on hybrid instruments should have no negative impact on the hybrid regulatory capital of insurers. This type of capital is not designed to create tax mismatches and its use does not constitute a harmful tax practice. Any rules placing an additional tax burden on these instruments would increase the cost of raising capital and consequently adversely impact the competitiveness of the insurance sector.

In all jurisdictions, regulators require insurers to hold an appropriate amount of capital in order to ensure that policyholder claims are paid out in all circumstances. This requirement constitutes in effect a protection for policyholders. Without capital, risk can't be assumed and, therefore, insurance business cannot be written (i.e. the insurer cannot operate). The precise amount of capital depends on the regulatory regime in question and on the nature of the underlying risk. But in all situations, this will be the minimum amount of capital that is held by the insurer. In addition to regulatory capital, rating agencies impose additional conditions to satisfy credit rating requirements. For insurers, the rating applied is critical as certain types of investors may only be able to invest in entities with a prescribed minimum credit rating; insurers and their brokers placing reinsurance will examine the reinsurer's credit rating very critically. Therefore, the maintenance of an appropriate level of capital within a jurisdiction is not a business choice for insurers, open to flexibility depending on tax treatment but instead it is critical to insurers' ability to carry on business. Virtually all major European insurers have issued such instruments in the market.

Insurers reap the following benefits when issuing hybrid instruments:

- Hybrid instruments allow insurers to raise capital in a cost-effective way, as debt carries less risk for the investor and, as a result, provides a cheaper form of capital than equity.
- Hybrid instruments enable an insurer to raise "risk" capital without having to issue equity and thereby diluting existing shareholders.
- Despite their features — which combine debt with equity characteristics — hybrid instruments are typically bought by fixed income rather than equity investors. As a result, hybrid capital instruments broaden the investor base for regulatory capital instruments for insurers.

Moreover, regulatory hybrid capital instruments used by insurers are typically placed in the market in form of bonds. With respect to the issuance process, the bonds are usually sold to international investors in a book building process via banks, which buy the bonds from the issuer and immediately sell them to investors. There is, therefore, little or no direct contact between the issuing insurance company and the investors. Even on the day of pricing of a new transaction, the issuing insurance company has only limited information on the identity of the bond investors. Also, during the payment process (coupons & principal) there is no direct contact between issuer and holder because the former typically employs paying agents (banks) to make payments.

For these reasons, Insurance Europe strongly believes that both external (widely held and/or traded) and intra-group hybrid capital issued for regulatory (and rating) purposes in the insurance sector should be explicitly exempted from any hybrid financial instrument rule, as these types of capital are issued for non-tax purposes and cannot be regarded as tax abusive.

The OECD's recognition that the hybrid financial instrument rule should only apply to a financial instrument entered into with a related person or where the payment is made under a structured arrangement and the taxpayer is party to that structured arrangement is welcomed by the insurance industry, as it preserves insurers' ability to use these capital instruments as explained above and avoids an unreasonable compliance burden. Indeed, without a carve-out for unrelated parties, an insurer would have to understand the tax treatment for all assets it owns in the member state of the issuer; this would be a highly disproportionate regulatory requirement.

The final OECD BEPS Action 2 report states that "countries remain free in their policy choices as to whether the hybrid mismatch rules should be applied to mismatches that arise under intra-group hybrid regulatory capital". In this context, Insurance Europe strongly recommends that the scope of anti-hybrid rules at EU level should not include hybrid regulatory capital. In addition, any European hybrid rules should be fully consistent with the OECD BEPS rules.

Controlled Foreign Company (CFC) Rules

- Insurance Europe is strongly of the view that income arising from risk assumption in a different territory to the location of the risk is not an automatic indicator of BEPS activity. CFC rules should not restrict the commercial operations of insurers and arrangements which are demonstrably required to optimise capital efficiency and to reinsure third-party risks.

Any discussion regarding the taxation of the insurance sector and any perceived avoidance should take into account the very specific assumption of risk which is insurers' core activity, as well as the regulatory requirement to hold the necessary capital to support the business written. Generally, an insurer's "*risk assumption*" activities will fall within the category of underwriting, which is crucial in the decision to accept a particular insured risk (over which insurers themselves have no control) and, therefore, essential for carrying out insurance business. For insurance groups, the pooling and diversification of different categories of risk is crucial to their business, and this often involves shifting risk across borders. Insurance is often written globally and insurers have to use both internal and external reinsurance and retrocession in the process of managing the risks they take on. It does not follow that this transfer of risk is tantamount to BEPS. Rather, it is the very nature of the insurance industry to transfer risk and to maintain capital in a single location to maximise pooling the diversification benefits.

When a reinsurance contract is concluded, a genuine transfer of risk takes place between the parties. In fact, both the regulator of the insurer and that of the reinsurer need to be satisfied that the reinsurer has the needed capital and capability to take on and effectively manage the risk transferred. Intra-group reinsurance should therefore continue to be subject to the OECD's transfer pricing rules and the arm's-length principle and only insurance income that raises BEPS concerns should be the subject of CFC rules.

With Action 3, the OECD developed CFC rules which are effective in dealing with BEPS issues. The OECD's proposals are considered a best practice standard and are not mandatory. This is because many jurisdictions already have well-functioning CFC rules; in fact, approximately half of EU member states do.

The Commission has proposed a number of CFC provisions (not applicable to financial undertakings) in the anti-tax avoidance package and is currently considering the inclusion of CFC legislation in respect to third countries in the re-launch of the CCCTB in November 2016. The Commission has indicated that these new provisions may include a carve-out for the insurance industry.

Concerning this subject, Insurance Europe would highlight that Article 3 of the proposed ATA Directive which states that the text of the Directive "shall not preclude the application of domestic or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases" should not be construed to allow the carve-outs for financial undertakings from CFC and (temporarily) from interest limitation rules to be overridden.

In the context of already proposed and potential future CFC rules, a particular focus of the Commission seems to be on intra-group reinsurance, as exemplified in the Q&A which accompanied the publication of the anti-tax avoidance package (under question 10 sub point a). Insurance Europe does not recognise the type of arrangement exemplified here and would point out that, while it is legitimate to consider whether offshore reinsurance schemes are used for tax abusive practices, CFC rules should not restrict the commercial operations of insurers and arrangements which are demonstrably required to optimise capital efficiency and to reinsure third-party risks, nor should they restrict the free movement of capital within the common market.

The OECD provides guidance on how this can be achieved. On page 52 of the BEPS Action 3 report, the OECD states (in note 4) that "for example, CFC rules that attribute insurance income could exclude income from reinsurance activities that meet all or most of" a number of features, including the contract being priced on an arm's-length terms and there being a diversification and pooling of risk in the reinsurer. Insurance Europe is strongly of the view that income arising from risk assumption in a different territory to the location of the risk is not an automatic indicator of BEPS activity. This is merely a consequence of insurers managing risks on a global basis, including through reinsurance.

To avoid casting too wide a net in pursuit of legitimate objectives such as fighting abusive tax practices, Insurance Europe believes it is essential to introduce a "safeguard clause" for non-EU subsidiaries which have a real economic activity and substance. The parent company must be able to derogate from CFC rules when it comes to such non-EU subsidiaries, simply by proving that the subsidiary doesn't have as sole purpose the transfer of profits to a jurisdiction where taxes are lower than in the jurisdiction of the parent. In this context, Insurance Europe would also emphasise that the insurance supply chain and value drivers should be taken into consideration in any determination of whether an insurance company or subsidiary thereof has the necessary substance in a territory to undertake business.

In addition to the above considerations, it must be noted that insurers which are regulated in the European Union are allowed to write cross-border business under the EU Freedom of Services, including income-generating policies which cover risks in another EU member state.

As regards the specifics of the proposed CFC rules in the ATA package, Insurance Europe notes that one of the criteria used for pre-attribution assessment is whether or not the entity is subject to a low level of taxation in a non-EU jurisdiction, defined as less than 40% of the parent's effective tax rate in its home jurisdiction, rather than the average tax rate of Member States as in the current CCCTB proposal. The application of this criteria would obviously yield different results based on the level of taxation in the parent's home jurisdiction. Insurance Europe believes that, in order to ensure an equivalent application across EU countries, the criteria should be set relative to a fixed rate, which should be the lowest tax rate available in an EU country.

Interest limitation rule

Insurance Europe welcomes the European Commission's decision to allow a temporary exemption from interest limitation rules for financial undertakings, including insurance companies. Insurance Europe agrees that it is preferable to wait for the OECD to finalise its recommendations on this topic during the course of 2016 before coming up with EU-level proposals. This will ensure that any European proposals are in line with international standards, something which is of crucial importance. Insurance Europe is committed to contribute to the work of the OECD in devising specific interest deduction rules for insurance companies.

Insurance Europe would, however, point out that the interest limitation rule as currently defined in the ATA Directive differs to the OECD BEPS recommendations. As for every other provision of the Directive, Insurance Europe believes that it should be aligned with the OECD standards. In particular, there needs to be a Public Benefit Project exclusion, which needs to have a wide scope. Insurers invest significantly in public benefit projects (e.g. infrastructure) and European policymakers are encouraging them to do even more (most notably as part of the EU Investment plan) as these investments meet the policy objectives of governments. Therefore, the exclusion from interest limitation rules needs to be widely drawn to allow for such investments.

Finally, Insurance Europe would reiterate that Article 3 of the proposed ATA Directive, which states that the text of the Directive "shall not preclude the application of domestic or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases", should not be construed to allow the carve-outs for financial undertakings from CFC and (temporarily) from interest limitation rules to be overridden.

Country-by-country reporting (CbCR)

Insurance Europe supports the European Commission's decision to amend the Administrative Cooperative Directive (DAC) to include provisions for the automatic exchange of country-by-country reports between national tax authorities. This represents full alignment with the OECD recommendations in Action 13 of the BEPS Action Plan and will ensure appropriate levels of transparency toward tax authorities. In order to facilitate country-by-country reporting, Insurance Europe believes it is essential that the contents of the reports for the purposes of the DAC are identical to those of the OECD BEPS Action 13. This would allow multi-national enterprises to fulfil intra-EU and extra-EU reporting requirements by filling in and submitting a single template.

Insurance Europe understands that the Commission is considering a separate proposal that would require the publication of country-by-country reports. Insurance Europe questions the incremental benefits of such a proposal and remains of the opinion that there is no need for the EU to introduce additional transparency requirements that go beyond the OECD's BEPS recommendations. This would not combat aggressive tax planning, harmful tax regimes and tax fraud but will potentially harm the competitiveness of the EU. Working towards a greater degree of harmonisation and offering guidance and tools to enable the effective implementation of international standards in the EU would be a far more effective way to achieve these objectives than reporting country-by-country information to the public. Insurance Europe, therefore, reiterates its strong concerns against proposals regarding the potential extension of the scope for the mandatory publication of country-by-country reports (CbCR) to all entities, which goes against the recent political agreement on the Accounting Directive and Corporate Social Responsibility (CSR) Directive. Insurance Europe's detailed rationale is explained in the response to the European Commission's recent consultation on further corporate tax transparency.