Insurance Europe comments on OECD's Public Discussion Draft on BEPS Action 3: Strengthening CFC Rules

Our reference:	ECO-TAX-15-069	Date:	30 April 2015
Referring to:	OECD Public Discussion Draft on BEPS Action 3: Strengthening Controlled Foreign Company (CFC) Rules		
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Pages:	4	Transparency Register ID no.:	33213703459-54

Insurance Europe supports the objective of the Organisation for Economic Cooperation and Development (OECD) Base Erosion and Profit Shifting (BEPS) action plan to tackle weaknesses in the international tax environment and welcomes the opportunity to comment on this discussion draft. Insurance Europe also supports the aim of developing controlled foreign company (CFC) rules which are effective in dealing with BEPS issues.

However, Insurance Europe believes that this discussion draft lacks a clearly articulated policy objective; in fact, it attempts to satisfy multiple competing objectives, resulting in what is in Insurance Europe's opinion a set of complicated and conflicting proposals. Insurance Europe is concerned that the CFC proposals could undermine the detailed work already done under other BEPS actions. In this context, Insurance Europe would also point out that CFC rules should be devised to deal with BEPS issues but that they should not go further than that.

Specific comments

Chapter 2: Definition of a CFC

Insurance Europe believes that no CFC charge should apply to fund vehicles because the use of funds doesn't relate to BEPS activities. Investment funds are primarily a means of making investments on behalf of third parties. As long as this fact can be proven and verified (ie as long as the fund is genuine) and income associated to the fund is taxed at an appropriate level, no CFC charge should apply.

Chapter 3: Threshold requirements

In Insurance Europe's view, this chapter should include minimum standards allowing countries some degree of flexibility in adopting CFC rules, thus avoiding an undue increase in compliance cost. For this purpose, Insurance Europe believes that CFC rules should be strictly applied on a yearly basis, without the need to obtain a disapplication ruling in the tax periods where CFC conditions are not fulfilled. Furthermore, CFC regimes should also include an appropriate *de minimis* profit threshold so as to avoid a disproportionate administrative burden.

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Any low-tax effective tax rate threshold should be arrived at using an average rate over several years as suggested in footnote 26 of the discussion draft. Finally, the effective tax rate should not fall under the required threshold due to the fact that tax losses have been used. Tax losses should be computed according to the tax law of the respective CFC entity.

Chapter 5: Definition of CFC income

Insurance Europe believes that only insurance income that raises BEPS concerns should be attributed under CFC rules and therefore welcomes the OECD's recognition of this in **paragraph 85**.

Paragraph 89 of the discussion draft addresses the substance analysis. In this context, Insurance Europe would point out that if few staff members are employed in a certain jurisdiction, it shouldn't be assumed the substance test cannot be met. Such an assumption wouldn't hold in insurance and in particular in reinsurance, where it can be that only a small number of well-qualified staff (like underwriters and actuaries) is required to effectively take on and manage insurance risk. In addition, the paragraph doesn't consider the fact that it is not unusual in the insurance sector (which can be down to regulatory requirements) for staff to be employed by a service company of the insurance group and not by the insurance company operating in the jurisdiction itself. This arrangement should be taken into account in the context of employees and establishment analysis.

Given that the 2010 OECD report on the attribution of profits to permanent establishments provides a comprehensive analysis of the insurance value chain in its part IV, Insurance Europe would suggest that this should serve as a basis when deciding whether an insurance company has the necessary substance in a territory, irrespective of whether the insurer is in a low or high tax jurisdiction. Insurance Europe also believes that the viable entity analysis has considerable advantages (as explained in the second bullet point of **paragraph 92**).

Paragraphs 98 and 99 set out a possible rule for dividends and for interest income which states that they will generally be treated as passive unless certain requirements are fulfilled. This rule goes beyond current rules applicable in certain jurisdictions (such as Germany), where dividends in particular are generally treated as active income.

Paragraph 102 expresses concerns that profits of insurance companies may easily be shifted away from jurisdictions in which those risks are located into a low-tax jurisdiction and that CFC attribution might play a role in preventing BEPS in this context. Insurance Europe believes that this logic does not reflect the real structure of insurance operations which is heavily influenced by regulation and capital management. In general, insurance is the contractual assumption of risks by one party in exchange for a premium payable by another party. This is how insurers create value for the wider economy. 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. This generates important benefits via diversification, flexibility in global risk management and capital efficiency. Therefore, it should not be suggested that income resulting from underwriting must remain in the same territory as the risk covered by the insurance policy. Insurance Europe is strongly of the view that it does not mean that if insurance income is in a different territory to the risk, there is BEPS activity. This is merely a consequence of insurers managing risks on a global basis, including through reinsurance.

For insurance groups, the pooling and diversification of different categories of risk is crucial to their business. This fact is recognised both by rating agencies and regulators. The pooling of insurance risk in one entity also facilitates the purchase of external reinsurance whereby the insurance group transfers risk to third-party reinsurers. 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.

If there is a perceived threat posed by the risk and capital of insurers then this should be addressed through the transfer pricing BEPS actions, particularly actions 8-10. Intra-group reinsurance should therefore remain subject to the OECD transfer pricing rules and the arm's-length principle. Additional tax rules like 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.

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 when income-generating policies cover risks in another EU member state.

Paragraph 112 sets out a possible rule for insurance income under the CFC regime: "*Income from insurance will generally be treated as active (and therefore excluded) unless (1) the income was derived from contracts or policies with a related party or (2) the parties to the insurance contract or the risks insured were located outside the CFC jurisdiction. However, income from insurance that falls under these two exceptions will only be treated as passive (and therefore included) if the CFC was overcapitalised or did not have sufficient substance to assume and manage the risks on its own accord.*"

The paragraph should be clarified with respect to what "overcapitalisation" means in this context and to which capital is relevant in this consideration (eg Solvency I regulatory capital of the country of residence, Solvency II risk capital, a comparable average capital of competitors in the market etc). Insurance operating subsidiaries are generally not overcapitalised, given that this would make no commercial rationale even if a subsidiary is located in a low-tax jurisdiction. Excess capital in a subsidiary is routinely passed up to the parent company so that it can be deployed easily in another territory if needed. A definition of the substance requirement would also be desirable.

In addition, Insurance Europe would point out that an excess profit approach is not appropriate for insurance income because it is never known at the outset of the (re)insurance contract whether a profit or a loss will result from the policy.

Chapter 6: Rules for computing income

In general, Insurance Europe believes that the rules for computing income should be simpler and easier to understand for the taxpayer. Insurance Europe recommends that there should be minimum standards that allow countries to have flexibility in adopting rules that do not unduly jeopardise competitiveness, such as rules that avoid mismatches and thus a wrong application of CFC rules.

Insurance Europe believes that the recommendations should allow relief for losses to be set off either against other CFC profits in the same territory in the same year or to carry forward in the CFC against profit in later years. This is because substantial real losses can occasionally arise in insurance.

Paragraph 131 recommends using the rules of the parent jurisdiction to calculate a CFC's income. It should be clarified that that this applies only for passive income.

Chapter 7: Rules for attributing income

Paragraph 143(v) recommends that in the context of income attribution, the tax rate of the parent jurisdiction should be applied. Here it should be clarified which tax rate is meant exactly and whether trade tax should be included or not.

Chapter 8: Rules to prevent or eliminate double taxation

Paragraph 155 recommends that in order to prevent double taxation, a credit for foreign taxes should be allowed. It should be clarified that foreign tax credits include CIT and trade tax.

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