Insurance Council of Australia

2 September 2022

Assistant Secretary
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: MNETaxIntegrity@treasury.gov.au

Dear Sir or Madam

Multinational Tax Integrity and Enhanced Tax Transparency

The Insurance Council of Australia **(Insurance Council**)[1] thanks Treasury for the opportunity to provide brief comment on the *Government election commitments: Multinational tax integrity and enhanced tax transparency, Consultation Paper, August 2022* (**Consultation Paper**).

We would like to make some initial targeted comments in relation to the proposed multinational enterprise (**MNE**) interest limitation rules and the appropriateness of their potential application to insurers. The industry's view is that insurers should be excluded from application of the proposed fixed ratio rule, as recommended by the Organisation for Economic Cooperation and Development (**OECD**).

In particular, we note that the general insurance industry has an inherently volatile profitability profile. This was most recently seen by the impact of the East Coast flooding on the sector earlier this year. Given this profitability profile, application of the fixed ratio rule (discussed below) to the sector would create a moving bar for interest deductions that inhibits the industry's ability to plan, raise capital, and withstand the ongoing and increasing challenges posed by climate change. Further, such a change would hinder the industry's focus on helping the community reduce risk so as to be able to provide affordable insurance options to consumers and businesses.

Background

In 2015 the OECD outlined a framework in Action 4 of the Base Erosion and Profit Shifting (**BEPS**) program to limit interest deductions. Action 4 is focused on the use of third-party, related party and intragroup debt to obtain "excessive" deductions or to "finance the production of exempt or deferred income" and recommends an approach based on a fixed ratio rule, supplemented by a worldwide group ratio rule. The OECD recommended a fixed ratio test to limit net interest deductions to 30 per cent of Earnings Before Interest, Taxes, Depreciation, and Amortisation (**EBITDA**), subject to caveats.

[1] The Insurance Council is the representative body of the general insurance industry in Australia and represents approximately 89% of private sector general insurers. As a foundational component of the Australian economy the general insurance industry employs approximately 60,000 people, generates gross written premium of $59.2 billion per annum and on average pays out $148.7 million in claims each working day ($38.8 billion per year).

We understand that the Government, as part of its election commitment platform, announced a multinational tax integrity package to address tax avoidance practices of MNEs, including amending Australia's existing thin capitalisation rules to limit interest deductions for MNEs. This is consistent with the OECD's recommended approach under Action 4 of the BEPS program.

Part 2: MNE interest limitation rules

The Insurance Council supports the Government's intent to implement the OECD BEPS Action Plan to address known weaknesses in the international tax environment. However, we also draw your attention to, the OECD's acknowledgement in Action 4, that a different approach may be more appropriate when dealing with entities in the insurance sector. There are sound reasons for the OECD's caveat.

In particular, as explained further below, it would be reasonable for a country to exempt insurance groups from the fixed ratio rule and group ratio rule where no material risks are identified in that country and for these groups to continue to be subject to the existing thin capitalisation rules. This is the situation outlined in the Consultation Paper for financial entities and authorised deposit-taking institutions, and which the Insurance Council believes should also apply to general insurers.

Reasons to apply the OECD's recommended approach to Australian insurers

The Insurance Council draws the following relevant considerations to your attention. These support the adoption of the OECD recommendation that insurers be exempted from the fixed ratio rule:

- **Highly regulated**: Insurance groups are subject to strict regulatory capital rules which limit their ability to excessively gear their operations. Insurance groups are required to hold minimum amounts of equity, set at "unquestionably strong" levels by the Australian Prudential Regulatory Authority (**APRA**) which acts as a *de facto* debt limitation rule for the insurance sector. Insurance groups invest premiums in stable income producing assets, often long-term debt instruments to generate income and ensure sufficient liquidity to pay claims as they fall due. As such, most of an insurance company's investments are funded using premiums, rather than using debt to fund equity investments in subsidiaries as might occur in some other industries. In the insurance industry regulatory and commercial imperatives drive a group's funding structure and the location in which debt is raised, rather than tax considerations.

- **Net lenders/Net interest income**: Insurance companies as investors of premium income are key providers of debt finance in corporate bonds, and typically experience net interest income rather than net interest expense. Where this is the case, the proposed measures will have no application as they operate to limit net interest expense (i.e. interest expense net of interest income).

- **Increased compliance costs**: Insurers often have substantial EBITDA volatility due to the nature of the industry. Given the uncertainty around EBITDA due to that volatility, insurers may be forced to apply an alternative thin capitalisation test, such as the worldwide gearing or arm's length debt test. This would significantly increase compliance costs and the thin capitalisation compliance burden.

Part 3: Multinational tax transparency

The Government also addresses the tax transparency (improved public reporting) elements of the Government's MNE tax integrity package in the Consultation Paper. Again, the Insurance Council supports the Government's view that transparency is a key factor underpinning the integrity of the tax system. However, we would like to make the following comments:

- There are overwhelming commercial reasons for insurance companies to establish operations in low-tax jurisdictions (e.g. Bermuda) – including access to global reinsurance markets and accessing global regulatory regimes. Operations in these jurisdictions do not result in harmful tax minimisation outcomes in the insurance industry because of Australia's Controlled Foreign Company (**CFC**) rules and offshore reinsurance tax framework (Division 15) which operates to tax reinsurance profits referable to Australian risks in Australia.

- Furthermore, the OECD's Pillar 2 regime (Global Minimum Tax), which was endorsed by the Government as part of its pre-election policies, will further reduce the ability of multinationals to conduct harmful tax practices involving low tax jurisdictions.

- We recommend that any new disclosure regime includes an exception to disclosure in some circumstances to recognise the types of activities that are not motivated by tax avoidance and do not represent a "material tax risk" when good commercial reasons exist.

Should the Government reach the conclusion to retain application of the fixed ratio rules to insurers, we would be pleased to meet with Treasury to discuss options to limit unintended consequences for the insurance sector.

We trust that our initial observations are of assistance. If you have any questions or comments in relation to our submission please contact Aparna Reddy, General Manager, Policy – Regulatory Affairs, on telephone: + 61 427 902 960 or email: areddy@insurancecouncil.com.au.

Yours sincerely

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