Keeping Up with Tax for Insurance

November 2019

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Introduction

Welcome to our November edition of Keeping Up with Tax for Insurance. As usual (or at least usual right now!), it's been another very busy month in UK politics. We had originally intended to make this edition a 'budget special' to provide full coverage on what promised to be a fascinating Budget 2019, with a Halloween Brexit already a memory. However, Parliament had other ideas, and the UK is now heading into a general election on 12 December.

As the government is now in a purdah period before that election, we will not get any further updates from them on upcoming tax measures until at least late December/early next year. That said, we do expect tax policy will be a key feature in the manifestos of all the main UK political parties and we may expect to see further change whichever government is in Downing Street on Friday the 13th. Watch this space for how any new measures may impact insurance groups.

In the meantime, there's been plenty going on in the world of tax and insurance and we have as usual highlighted key developments. In particular, the recent issue of the GRI reporting standards for tax and further clarifications on the proposed EU public country by country reporting standards may impact significantly on tax (and wider) reporting required/advised for insurance groups, and the OECD released their public consultation document for Pillar II, looking at the introduction of common global minimum tax rules. We have summarised the headlines from these measures and steps insurers may wish to take. Otherwise, this edition includes a number of articles on recent or shortly upcoming developments in tax, including further guidance on IR35, the Irish finance bill and a number of developments on stamp taxes.

I would also like to take this opportunity to highlight our Global FinTech Report 2019, which we launched to the UK market on 14 October. Crossing the Lines is the third report in a series plotting the evolution of FinTech across the globe, and examines how the FS sector is seizing the opportunity that FinTech presents. With four headline messages focused on strategy, talent, best practice and cross-industry fusion, the report explores the current fintech landscape, the factors that will determine the likely winners and losers, and the steps that organisations can take to put themselves in the best position to lead.

We are running a number of training/networking sessions over the next few weeks that readers may be interested in:

- 13 November - Lloyd's Tax Training (fully subscribed)
- 26 November - Insurance Tax Manager's Forum
- 11 December - Insurance Tax Update

Please speak to me or a member of our insurance team if either of these sessions is of interest.

Finally, (not at all begrudging) congratulations to South Africa on winning the Rugby World Cup. Now time to get back to enjoying the cricket (although New Zealand are spoiling that for me too)!

I hope you enjoy the articles that we have put together, and as always please get in touch with me or your PwC team if there is anything that you would like to discuss further, or if you would like to attend one of our events.

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How will recent proposals for public country-by-country reporting affect insurers?

Country-by-country reporting (CbCR) is a term that is used broadly, but in simple terms it means reporting on certain financial information (e.g. revenue, profit, employees, assets, tax paid) on a country basis rather than a global basis. Under OECD BEPS Action 13, over 80 countries have passed legislation requiring companies to disclose this information privately to tax authorities, for use in risk assessment.

In addition to this, tax authorities have entered into exchange of information agreements where the CbCR will automatically be shared with tax authorities of countries named in the CbCR report. This reinforces the transparency agenda for tax authorities and places pressure on clients to ensure that they are telling a consistent story in the information they are reporting. From a UK perspective, by default of falling within the CbCR reporting regime (turnover of over EUR 750 million), UK corporates would also be required to publish a UK tax strategy. It is important to consider whether the statements made in the UK tax strategy are reflective of the approach the corporate is taking to CbCR.

This article explores recent developments in public CbCR and suggests next steps for insurers. There is pressure from some stakeholders, e.g. investors, analysts, NGOs for this information to be disclosed publicly, to assist in understanding of a company's tax affairs.

Proposals in the EU for public CbCR

In April 2016, the European Commission put forward a proposal for an initiative for large multinational companies to report publicly on where their profits arise and where these are taxed. The purpose of the proposal was to increase transparency and tackle tax avoidance within the EU. This was adopted by the European Parliament in July 2017 and the proposal moved to trilogue negotiations between the EU Commission, EU Parliament and the Council of Ministers. The proposal had reached a deadlock in the Council of EU Member States, with no movement until very recently.

In September 2019, the German Federal Finance Minister (representing half of the German coalition government) announced support for public CbCR. In October 2019, MEPs adopted a resolution urging the Member States to agree a position to allow talks to begin between Member States and the European Parliament and finalise the legislative process. A key issue is whether this will be treated by the European Council as a tax issue (which would require Council unanimity) or a legal and accounting issue (which allows Council voting by means of a qualified majority). The scope of the draft legislation is outlined below. With increasing pressure from MEPs, we are likely to see further developments in the near future.

Content of EU public CbCR proposals

Who is in scope?	Undertakings with a consolidated net turnover of EUR 750m or more
Level of reporting for operations in member states	Data to be reported on a geographical basis for each Member State (and certain jurisdictions which are regarded as having inadequate tax governance)
Level of reporting for operations outside the EU	Aggregated level data (apart from certain jurisdictions noted above)
Content of template	Brief description of activities; number of employees; net turnover; profit or loss before tax; tax accrued (excluding deferred tax and uncertain tax positions) in the year, tax paid in the year; accumulated earnings
Commercially sensitive information	To ensure fair competition, commercially sensitive information may be temporarily omitted if it is seriously prejudicial to the commercial position of the company
Availability	Publicly available on the company's website

Global Reporting Initiative (GRI) draft standard 207: 'Tax'

As well as proposals in the EU, insurers should be aware of GRI proposals for public CbCR. This is particularly important if your company follows the GRI standards. The GRI sustainability reporting standards are widely accepted global standards for sustainability reporting and many companies state that they are GRI compliant. The GRI has issued a draft standard on 'tax' which contains a requirement for public CbCR. The draft standard is expected to receive approval in December 2019 and be effective from January 2021.

The requirements are similar to those under the OECD BEPS disclosures (see table), apart from item x. which is a reconciliation from statutory to effective rate at a country level. In addition, the draft standard contains a requirement to reconcile the disclosures to the audited consolidated financial statement, which is not required under OECD BEPS.

The draft standard contains recommended disclosures (not shown in the table) including for example employee remuneration, taxes withheld and paid on behalf of employees, taxes collected from customers on behalf of a tax authority, other taxes or payments to governments, significant uncertain tax positions and intra-company debt.

Internal communication with teams responsible for sustainability reporting to assess the company's links with the GRI standard is key.

How will recent proposals for public country-by-country reporting affect insurers? (cont.)

The reporting organisation shall report the following information;

a. All tax jurisdictions where the entities included in the organisation's audited consolidated financial statements, or in the financial information filed on public record, are resident for tax purposes.

b. For each tax jurisdiction reported in disclosure 207-4-a:

   i. Names of the resident entities;
   ii. Primary activities of the organisation;
   iii. Number of employees, and the basis of calculation of this number;
   iv. Revenues from third-party sales;
   v. Revenues from intra-group transactions with other tax jurisdictions;
   vi. Profit/loss before tax;
   vii. Tangible assets other than cash and cash equivalents;
   viii. Corporate income tax paid on a cash basis;
   ix. Corporate income tax accrued on profit/loss;
   x. Reasons for the difference between corporate income tax accrued on profit/loss and the tax due if she statutory tax rate is applied to profit/loss before tax.

c. The time period covered by the information reported in Disclosure 207-4.

Existing CbCR requirements – sector specific initiatives

Sector specific initiatives already require a form of public CbCR. The EU Accounting Directive requires mining and forestry companies to report on the taxes, royalties and bonuses that they pay worldwide. The Capital Requirements Directive (CRD IV) requires credit institutions and investment firms to publish certain tax and financial data for each country where they operate. While an awareness of these sector specific initiatives is helpful, they are not relevant for insurance companies.

Learnings from CbCR so far

Clients have now made CbCR submissions for at least two financial years. As time has moved on, clients are considering ways to make their CbCR process more robust. In particular:

- Identifying who has overall responsibility for the preparation of the CbCR, and the internal stakeholders who feed into the preparation process. Following this, formally documenting the roles and responsibilities of these internal stakeholders so that the right accountability is in place.
- Updating risk management and process documentation to include the CbCR preparation process, and developing further documentation and controls where gaps have been identified
- Providing training and education to relevant internal stakeholders, and 'refresher' training.
- Assessing whether there are opportunities to improve the quality and sources of data through small automations, or leveraging wider business technology initiatives. Further, as the CbCR relies on data that is also used for other regulatory and compliance reporting obligations, is there an opportunity to streamline a consistent set of data that can be used to meet the various regulatory and compliance reporting obligations, reducing the time and pressure which resources may currently be facing.

In light of the impending public CbCR, companies should assess whether the above considerations have been addressed within their operating environment. If not, what additional steps should be taken.

Voluntary reporting

CbCR data can be challenging to interpret, creating confusion rather than clarity over a company's tax affairs. A comparison of ratios, for example, profit per employee, can be misleading, but more sophisticated analysis is time consuming and complex. It is important then for companies to provide narrative so that their approach to tax is understood, particularly in the face of potential public CbCR. Some companies subject to sector specific initiatives have developed narrative to explain their tax affairs in more detail This might include details of Total Tax Contribution, highlighting the company's contribution in all taxes, beyond corporation tax, which is particularly relevant for insurers given the significance which is particularly relevant for insurers given the significance of irrecoverable VAT. Some companies recognise that their contribution goes beyond tax to include economic, social and environmental impact and include disclosures to quantify their broader impact.

Some companies have voluntarily published CbCR disclosures. Our latest review of tax disclosures showed that six companies in the FTSE 100 have published some form of CbCR, containing a geographical split of revenues, profit, employees and tax paid. The most comprehensive of these is Vodafone. The report contains table 1 of Vodafone's OECD BEPS filing together with an explanation of why the disclosure is complex to understand, for example double counting in the revenue line. Vodafone also publish their own assessment of their contribution to the public finances in different countries and a business model to explain where revenue and tax arises.

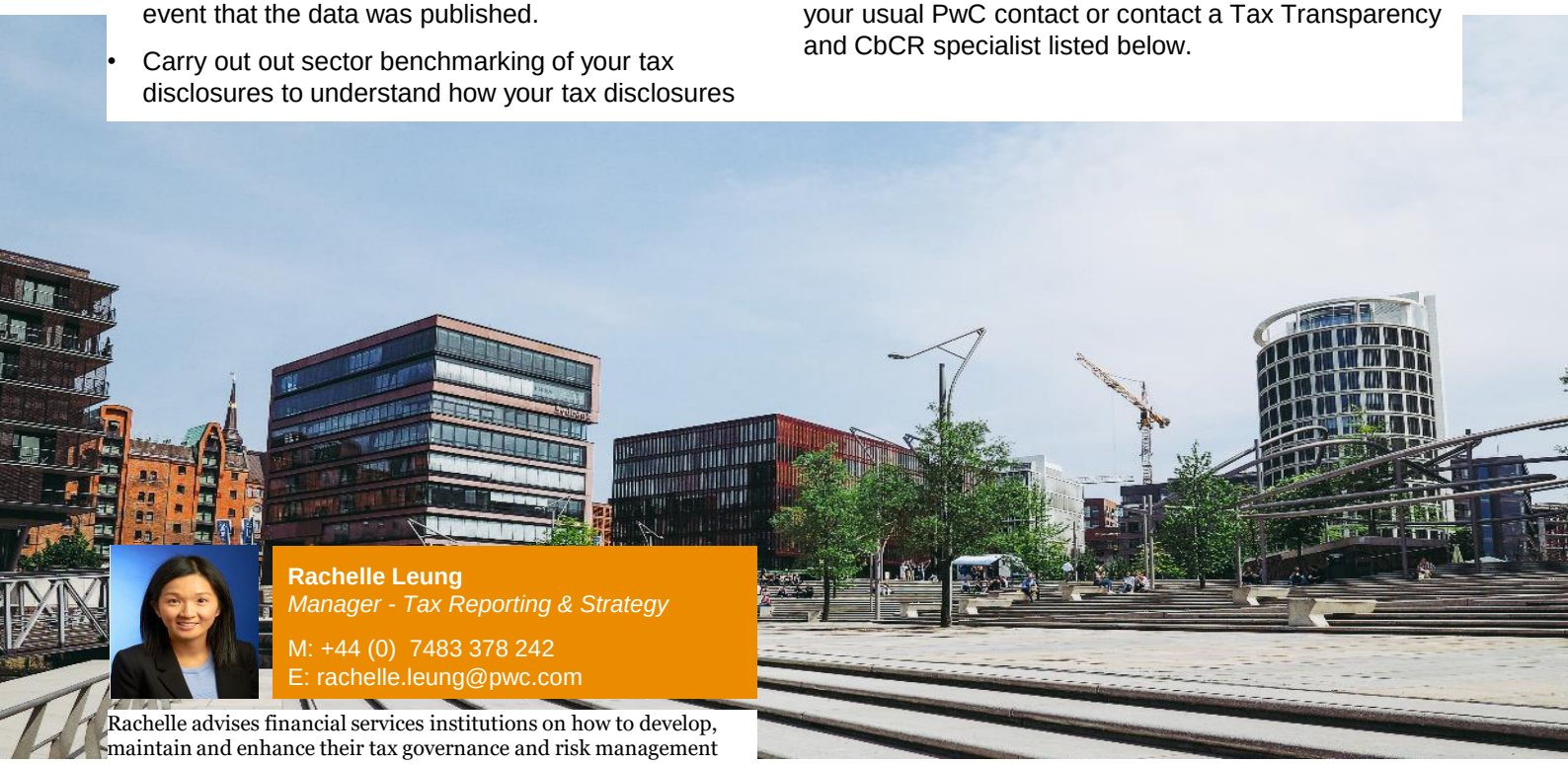
How will recent proposals for public country-by-country reporting affect insurers? (cont.)

Next steps for Insurers

Stay ahead of the debate by understanding the current developments in public CbCR. Consider whether there is value in developing additional disclosures, if not for publication, then for internal briefings.

- Link in with your corporate responsibility team to understand whether and to what extent your company's sustainability reporting follows GRI standards.
- Review your OECD BEPS CbCR data and consider whether additional narrative would be helpful in the event that the data was published.
- Carry out out sector benchmarking of your tax disclosures to understand how your tax disclosures compare to your peers. Use these insights in a tax transparency workshop to explore the issue of 'tax transparency to whom and for what purpose?' to help develop an informed approach to tax transparency.
- Ensure that the board or audit committee are briefed on trends in tax transparency so that they can assess the risks.
- Use our data analytics CbCR benchmarking visualisation to understand how your CbCR data compares to your peers on an anonymous basis.

For a conversation on the issues above, please speak to your usual PwC contact or contact a Tax Transparency and CbCR specialist listed below.



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OECD releases consultation document on global minimum tax design (Pillar II)

In brief

On 8 November, the OECD published their public consultation document: Global Anti-Base Erosion Proposal ('GloBE') (Pillar Two) ('the Consultation'). This consultation is seeking stakeholders' views on the introduction of common global minimum tax rules across the 130 countries participating in the OECD work in this area. The OECD is proposing these rules operate by requiring additional top up taxes and other defensive measures where a multinational group's income is not subject to sufficiently high levels of tax, with detailed rules required to define both the minimum rate and the minimum tax base under these rules.

The Consultation is the second part of the OECD's efforts to develop a two-pronged solution (alongside 'Pillar 1' Proposals, which seek to rewrite profit allocation rules for large 'consumer facing' businesses) to the tax challenges arising as a result of globalisation and digitalisation. Unlike the Pillar 1 proposals, however, this latest consultation envisions minimum tax rules that apply to large international businesses in all sectors (subject to potential carve-outs) and could therefore significantly increase tax and compliance costs for an even wider range of businesses, including the insurance sector.

In detail

The proposal

The Consultation makes clear that it only addresses part of the Pillar 2 issues set out in the May 2019 Programme of Work. In particular, the document is focused on the development of an 'income inclusion' rule, which would seek to top up the foreign taxes paid by a business' overseas branches or controlled entities to a minimum rate. Subject to consultation, the starting point for such a calculation appears to be financial accounts, but it is an open question whether these would be local accounts, or the consolidated accounts of the group's ultimate parent entity.

While the broader proposals are also expected to include rules to deny tax or treaty benefits deductions where the recipient of a payment is not sufficiently taxed (the 'undertaxed payments rule' and 'subject to tax' rules), and a new treaty rule to allow residence countries to top up taxes on income attributable to foreign branches' immovable property (the 'switch-over' rule), the focus of the Consultation is primarily the income inclusion rule; where comments are made on the other elements of the proposals, they are limited to enquiries on whether different approaches would need to be taken in relation to them.

Broadly, there are three key technical areas covered by the Consultation:

- *Financial accounts:* The Consultation recognises there is a balance to strike between simplicity and the accuracy of identifying truly low taxed profits, given the differences between accounting standards and tax bases. For differences that would not even out over time (e.g. non-taxable income, or non-deductible expenses), the Consultation suggests that removing certain amounts as standard could be an appropriate middle ground. For pure timing differences, three options are suggested: carrying forward any excess taxes paid for offset in future years, using IFRS deferred tax accounting standards rather than the cash tax recognised in the accounts, or averaging over multiple years.
- *Blending:* The Consultation also seeks views on the degree of 'blending' that should be included. This is essentially determining whether groups could consolidate taxes at an entity, jurisdiction, or worldwide basis in order to determine whether the effective taxes paid on profits are sufficiently high. The factors under consideration in this regard include the cost of compliance, the impact on volatility, and the allocation of profits and taxes between entities and jurisdictions.
- *Carve-outs:* The Consultation recognises that carve-outs may be required, and that there is often a trade off between certainty and complexity. No industries or regimes are specifically identified as potential targets for carve-outs, but broad questions are raised for stakeholders to consider, such as whether carve-outs may be appropriate on the basis of a group's global size or industry, or the scale of local presence, as well as the potential behavioural impacts that carve-outs may have. It is worth noting that no mention is made of the rumoured carve-out for the US GILTI regime, or any carve outs for the FS sector though the latter may be key for insurance groups in due course.

Next steps

Following a period to 2 December for stakeholders to provide written comments, a public consultation meeting will take place in Paris on 9 December. The OECD is seeking political agreement among its members on the basic structure of the proposed changes in January 2020, so that more detailed technical work can take place on these measures in 2020. Given the complexity of these proposed rules, industry engagement throughout this process will be essential to ensure we reach a workable/appropriate regime (even assuming the FS sector is not successful in arguing for a carve out for some or all of its activities).

OECD releases consultation document on global minimum tax design (Pillar II) (cont.)

The takeaway

While this workstream is being delivered under the OECD's "Tax Challenges Arising from the Digitalisation of the Economy" project, the impact of the proposals being implemented go far beyond highly digitalised businesses; these proposals seek to address more fundamental concerns for which the BEPS Project did not provide an adequate solution; the risks of activities and profits being moved to low- (or no) tax jurisdictions. The potential impact should be closely monitored by all international businesses, including those who do not operate in low-tax jurisdictions and those already subject to US GILTI rules.

Levels of enthusiasm for Pillar 2 appear to be mixed among the OECD's member countries (although with clear support from some key G7 countries), but there is fairly broad political support for the wider package. The OECD is working on the basis that both pillars would be agreed together, though this may still be politically challenging. While some countries are keen to ensure that all income is taxed at a minimum rate, others want to take a broader view that allows countries the flexibility to set lower rates from which groups suffering otherwise higher rates could benefit. Unlike the Pillar 1 proposals that seek to reallocate tax base between countries (on which there is expected to be broad consensus), it is possible that elements of Pillar 2 could be implemented by a smaller group of countries.

The rate of tax to which profits in scope must be topped up remains a key challenge for the OECD to agree (as different rates would be expected to bring different regimes within scope). This is not being addressed as part of the current consultation, but will be considered as part of the detailed work in due course. The interaction of the income inclusion rule with the other rules (and all their interactions with the Pillar 1 Proposals) is another key area that will need to be addressed but is not consulted on at this time.

There is significant complexity in each of the Pillar 1 and Pillar 2 proposals, and in their interaction with each other. Insurers will want to analyse the potential impact on their businesses, and the outstanding challenges outlined above. Clearly, given the complexity of these measures, they have the potential to impact on existing business models in the insurance sector, in particular around reinsurance strategies as well as giving additional compliance burdens, so this will need to be carefully considered as these rules progress.

Given the wide-ranging implications of this project, we recommend that insurers engage with the OECD and national governments to ensure that the industry's specific concerns in relation to these measures are addressed in the next phase of work.

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IR35 – 5 months to go

In previous editions, we outlined the terms of the off payroll working rules that are due to take effect from 6 April 2020 based on Consultation Documents issued by HMRC to date.

Since this date, draft clauses have been released for the forthcoming Finance Bill which would give legislative effect to these policy provisions and further guidance has been issued by HMRC seeking to address some of the more challenging aspects of the new rules.

With only a few months to go until the new regime takes effect, this article looks as some of the practical challenges insurers will need to consider prior to April.

Background

Currently, where an insurance company engages with its contingent workforce via personal service companies (PSCs) or other intermediaries, it is (normally) insulated from any obligation to assess the status of the worker and to apply PAYE/NIC. Instead this obligation sits with the worker (via his/her PSC).

From 6 April 2020, this responsibility will be transferred such that medium or large sized insurers will be responsible for assessing the employment status of the worker and any resultant PAYE, NIC and Apprenticeship Levy obligation will need to be met by the "fee payer" (which could be the insurance company "client" or a third party such as an MSP or agency).

For insurers who have typically have a large contingent workforce, this measure could have a number of effects:

- Cost - All things being equal, a contingent worker, who is regarded under IR35 as a "disguised employee" will attract a 14.3%, above the line cost, "surcharge" in the form of employer's NIC and Apprenticeship Levy. For insurers, this problem is compounded as IR35 doesn't change the VAT status of the worker and, therefore, they may continue to suffer blocked input VAT as well as an increased NIC bill. Furthermore, certain "critical" workers may require "make whole" payments to compensate them for a loss in take home pay;
- Operational risk - For insurers many contingent workers may be engaged on business critical projects or activities which are mandated by the regulators. Many of these contractors may be concerned with both the immediate tax hit of a disguised employment assessment under IR35 as well as the optics of the engager taking a view that is contrary to their previous "self assessment" in earlier years. In this regard, whilst a recent HMRC guidance note indicates that HMRC would "only use information resulting from these changes to open a new enquiry into earlier years if there is reason to suspect fraud or criminal behaviour", this is unlikely to fully alleviate contractor concerns given the statement's lack of statutory force and absence of an explicit prohibition of data being used in "open" or "routine" enquiries;
- Tax risk - In the UK, there is no statutory definition of employment. Instead, organisations and workers alike must look to a series of tests devised by the courts and paint a picture of whether the worker is, in reality, an employee based on the facts of each engagement. Such an assessment naturally requires a degree of judgment which is capable of being challenged by the worker, through a "client led" statutory appeals process, and HMRC. The draft legislation does, however, offer a form of safe harbour in the form of a "reasonable care" test and HMRC have also stated they will stand behind the results of their CEST assessment tool "provided the information input is accurate and the tool used in accordance with [their] guidance".

IR35 may thus be thought of as a balancing act for insurers, ensuring their compliance systems and/or operating model is designed to eliminate tax risk whilst simultaneously taking measures to reduce cost where appropriate and mitigate against operational risk.

IR35 – 5 months to go (cont.)

Understanding the current state

We would regard a current state assessment as being a critical precursor to any IR35 planning exercise. Such an exercise enables businesses to forecast the potential impact on their cost base, identify data or control deficiencies and any business critical resources potentially "at risk" under IR35.

Common problems at this stage include; identifying PSCs who meet the gateway tests for IR35 (but may be hidden amongst other vendors in the General Ledger or embedded in larger consultancy contracts), assessing for "disguised employment" status and modelling for the impact of different decisions

A desired end state

It is important that key stakeholders in any organisation have a shared vision of the desired end state for IR35 reform. This vision will be informed by agreement over key design principles and an understanding of the current state but must also be tempered by pragmatism given the short time remaining to be compliant.

Key questions informing this strategy include:

- What appetite is there for change within the organisation?
- Is there scope for wholesale/selective changes to operating/procurement models to reduce administration and/or cost or does the organisation simply want to create a process to ensure it can remain compliant under the new law?;
- Should a strategy be built to address an organisation's direct responsibilities or should a more holistic approach be taken to managing risk in the supply chain?;
- Does the organisation understand the labour market dynamics of its impacted workforce? What tolerance does the organisation have to workforce churn?

Executing the plan

Once there is this shared vision, an implementation plan can be developed, refined and put into action. Here too, there will be critical decisions and milestones. The details of this will depend on the aforementioned vision but may include, for example;

- the design of the assessment process and choice of platform;
- the development of a communications strategy and appeals process;
- the implementation and testing of appropriate compliance systems; and
- overall governance (including addressing any non-compliant models which may be marketed to the business).

Next steps for Insurers

IR35 represents a sizeable challenge for insurers given the large scale use of contingent workers.

Responsibility for managing the issue will cut across a number of functions and competencies but Group Tax should ensure it has a seat at the table and is able to influence each stage of the process from understanding the current state, through to developing and executing on the strategy.

Given the expansive nature of the issue and limited time remaining before the new rules take effect, we are recommending that all organisations ensure that they do not leave it too late to adequately plan for and deliver a compliant IR35 strategy.

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Irish finance bill 2019 – what does it mean for financial services?

Ireland's Finance Bill 2019 ("the Bill") contains the legislative changes required to give effect to the Budget Day announcements made on 8 October 2019, as well as some supplementary provisions not specifically addressed by the Minister in his Budget 2020 speech. From an insurance perspective, the most significant measure will likely be the introduction of the anti-hybrid rules which comprise 18 pages of new legislation. The complexity of the rules when applied to cross-border insurance business should not be underestimated.

The expansion of Irish transfer pricing rules is also a significant piece of legislative reform. The extension of Irish transfer pricing rules to certain non-trading transactions will clearly be a key area of the proposed reform to be considered by all taxpayers but we would expect the impact to be limited from an insurance perspective. Helpfully, the expansion of the TP rules has not been extended to regulated funds or PPL/Ns issued by Section 110 companies. However, additional anti-avoidance provisions are being introduced with respect to Section 110 companies in order to strengthen the existing protections included in this regime. These additional anti-avoidance provisions will need to be considered in detail by all insurers and asset managers owning/managing such vehicles.

The Bill contains a provision which disallows a deduction for "any taxes on income" as a trading deduction under general tax principles. This has been the long standing Irish Revenue view which they have now put onto a legislative footing. Furthermore, while most of the property related measures were announced on Budget day and given immediate legislative effect by way of Financial Resolution, the Bill includes further proposed anti-avoidance provisions today with respect to "holders of excessive rights" being unitholders who hold 10% or more of the units in an IREF.

The Bill also contains legislation required to implement the EU Directive 2018/822 ("DAC 6") and a number of other broadly welcomed clarifying provisions that we have considered below.

EU Anti Tax Avoidance Directive ("ATAD") Measures: Anti-hybrid Rules

The Bill introduces anti-hybrid rules into Irish legislation. Importantly, the rules apply to payments made or arising after 1 January 2020 therefore, unlike other ATAD measures, the rules will be effective for all taxpayers from the referenced date irrespective of the adopted accounting period. The legislative change is required for Ireland to comply with the EU's anti-tax avoidance directive, specifically ATAD II ("the Directive"). The anti-hybrid rules are aimed at preventing companies from benefiting from differences in the tax treatment of payments on hybrid financial instruments and on payments by or to hybrid entities. The new rules will deny deductions for such payments or, in certain circumstances, will subject the referenced payments to tax in Ireland.

The anti-hybrid rules are very complex and introduce some important new definitions and concepts into Irish tax legislation. Equally, the introduction of these rules has necessitated the need for some other statutory provisions to be introduced into the Irish tax code. For example, the tax treatment of stock lending transactions is being put on a statutory footing for the first time. Furthermore, the cross border nature of the rules will mean that the Irish tax treatment of certain entities/instruments will be determined by reference to treatment in a foreign jurisdiction, and hence a more detailed understanding of foreign tax treatment will therefore be required. This will undoubtedly lead to a greater administrative burden on taxpayers.

We have considered some of the key concepts below:

Associated Enterprise

A significant portion of the anti-hybrid rules only apply if the payment is made to an "associate enterprise". Two entities shall be 'associated entities' if:

- one entity, directly or indirectly, possesses or is entitled to acquire not less than 25 per cent of the share capital, voting power or has an entitlement to 25 per cent or more of the profits of that other entity (increased to 50% in certain circumstances), or
- both entities are included in the same consolidated group for financial statement purposes, or
- one entity is deemed to exercise significant influence over the other.

Significant influence is a new concept in the Irish tax code and has been specifically defined for the anti-hybrid rules purposes. It is broadly defined as the ability to participate in the financial and operating policy decisions of an entity by virtue of board representation.

Irish finance bill 2019 – what does it mean for financial services? (cont.)

Inclusion

Provided the payment is included in the recipient jurisdiction, the referenced deductibility restrictions do not apply. The definition of inclusion covers both payments that are subject to tax in the overseas jurisdiction as well as payments to exempt foreign entities. Furthermore, payments to entities that are located in a jurisdiction that does not impose tax are treated as included, provided that the profits or gains are treated as arising or accruing to that entity. A payment that is subject to a CFC type charge imposed under the laws of another territory will also be treated as included.

Dual Inclusion Income

In situations where a payment by a hybrid entity or a double deduction arises, a restriction will not arise if the payment can be offset against "dual inclusion income". This is income which is included in both Ireland and the jurisdiction where the mismatch situation arises. Ireland has sought to introduce a reasonable definition of "dual inclusion income" by introducing a jurisdiction test as opposed to an entity by entity test.

Imported mismatches

Imported mismatches, essentially payments which indirectly fund hybrid mismatches outside of Ireland, can also result in restrictions being imposed locally. Notably, the Bill prescribes that these rules do not apply where payments are made to other EU Member States which is a very positive development.

Other important definitions

The definition of "payee" which is the entity which must meet the inclusion test, "hybrid entity", which in itself determines the application of the rules in many cases, and the interaction of these definitions with each other will need to be carefully assessed by all taxpayers. The manner in which the definitions have been drafted, particularly the addition of a "participator" concept within the definition of payee, may result in situations where multiple payees can be identified in one transaction. This is arguably even more relevant in an insurance context given the multi-tiered nature of many structures.

Insurance impact and interaction with existing legislation

In terms of the potential impact of the new legislation on the FS sector, the measures which apply to payments under hybrid financial instruments are likely to have limited application in practice, the one exception being payments under profit participating loans/notes ("PPL/Ns") typically made by Section 110 companies. It is also positive that financial traders have been carved out from certain on market hybrid transfers subject to a number of conditions being met. These companies are already subject to restrictions on interest deductibility under rules which are not dissimilar from the anti-hybrid rules, and have been further strengthened in the Bill (see below for further detail). The new anti-hybrid rules will co-exist with this existing legislation and will therefore need to be considered in conjunction with same. The most significant impact is likely to be on groups or investment structures where US shareholders or investors are involved, due to the US "check-the-box" elections which can give certain entities a specific US tax designation. There are a number of additional anti-hybrid provisions in relation to disregarded permanent establishments, tax residency mismatches, withholding tax and structured arrangements that will need to be considered in certain situations.

Overall, Ireland has sought to introduce the anti-hybrid rules in a form which closely aligns with the wording of the Directive. The rules do not go beyond the requirements of the Directive and this is to be welcomed. Furthermore, the fact that the measures have been transposed in a manner which ensures the provisions can interact and coexist with existing Irish tax concepts will likely provide much needed certainty to taxpayers. Notwithstanding this approach the complexity of the rules should not be underestimated.

Transfer pricing

As expected, the Bill contains the draft legislation required to align Ireland's current rules with the 2017 OECD Transfer Pricing Guidelines and broaden the scope of transfer pricing in Ireland.

Overview of key provisions

The Bill introduces some new concepts into the Irish tax code. This includes incorporation of a direct reference to the 2017 OECD transfer pricing guidelines, inclusion of a "substance over form" provision, introduction of enhanced transfer pricing documentation requirements and extension to transactions involving small and medium-sized enterprises (SMEs) (subject to the execution of a Ministerial Order).

Irish finance bill 2019 – what does it mean for financial services? (cont.)

As expected, the Bill delivers an extension to cross-border non-trading transactions. The rules will now apply to taxpayers chargeable to corporation tax in both a trading and non trading context, at rates of 12.5% and 25% respectively. This is a significant extension of the transfer pricing rules and will bring a significant number of non-trading transactions within the scope of the transfer pricing legislation for the first time.

The provision also provides for to domestic transactions where the transaction was entered into with a main purpose of obtaining a tax advantage, as part of a wider arrangement with a foreign party. This acknowledges that fully domestic non-trading transactions do not pose the same type or level of risks posed by international/cross border transactions.

FS impact

While the extension of Irish transfer pricing rules to certain non-trading transactions will clearly be a key area of the proposed reform which will need to be considered by all taxpayers, we would expect the impact to be limited from a FS perspective. It is also positive to see regulated funds falling outside the scope of the new regime in its entirety.

The new rules mean that Irish Section 110 companies may fall within the scope of Irish transfer pricing rules to the extent that they engage in related party transactions. That said, while there may be additional documentation requirements to contend with, the fact that Section 110 companies are already obliged to enter into transactions on an arm's length basis means the formal extension of the transfer pricing rules contained within the Bill will therefore have a lessened impact on these vehicles in practice. The one exception to the existing arm's length requirement relates to payments under PPL/Ns issued by qualifying SPVs. Helpfully, the expansion of the TP rules have not been extended to regulated funds or PPL/Ns issued by Section 110 companies thus ensuring that these collective investment vehicles can continue to meet their policy objectives. However, the Bill introduces additional anti-avoidance provisions with respect to Section 110 companies in order to strengthen the existing protections included within the regime (see below for further detail).

Additional Section 110 amendments

The Bill makes amendments to the Section 110 anti-avoidance provisions, broadening the definition of a "specified person" as well as expanding the scope of specific anti-avoidance legislation.

The definition of control, which is a key factor in determining whether an entity constitutes a "specified person" under the existing anti-avoidance provisions, has been expanded to include persons who have "significant influence" over the Section.110 company. It is important to note that this definition is slightly broader than that contained in the anti-hybrid rules given that the test is not restricted to board, or an equivalent governing body, activity. That said, the new rule contains a two-pronged test whereby, in addition to having significant influence, an entity must also hold more than 20% of the share capital, PPL/N principal value or have the right to 20% of the interest or distribution payable under the PPL/N to fall within the scope of the rules.

The Bill also expands the specific anti-avoidance provisions to include all deductible PPN payments and moves this anti-avoidance provision to an objective basis. This has essentially moved elements of the 2018 Section 110 guidance onto a statutory basis and given the Irish Revenue greater ability to challenge situations where they believe transaction was not entered into for bona fide commercial purposes.

Property Related Measures

The Bill includes further anti-avoidance provisions with respect to "holders of excessive rights", unitholders who hold 10% or more of the units in an IREF. Under this new provision, certain returns made to such unitholders will be deemed as income accruing to the IREF and an income tax liability, equal to 20% of the gross return, will arise at the level of the IREF. In effect, this charge to tax will be borne by all unitholders in the IREF regardless of their proportionate shareholding as it will reduce the profits available for distribution.

Furthermore, it would appear that certain returns made to non-exempt unitholders holding 10% or more of the units in an IREF will now be subject to a charge to tax at both the fund level and investor level. Whether this apparent double charge to tax is intentional remains to be seen.

Irish finance bill 2019 – what does it mean for financial services? (cont.)

DAC 6: Mandatory reporting of cross border arrangements

The Bill introduces the primary legislation which is necessary to transpose the provisions of DAC 6 into the Irish tax code. The draft legislation introduces new obligations for intermediaries and taxpayers relating to the mandatory reporting of certain cross-border tax arrangements. The DAC 6 Directive aims to strengthen transparency on cross-border tax arrangements by requiring individuals, corporate tax payers and intermediaries, such as law firms, financial institutions and other advisers, to identify and report very detailed information on a broad range of cross-border tax arrangements when they meet certain criteria, known as hallmarks (which are very broadly defined).

While the Bill has aligned the domestic rules very closely to the DAC 6 Directive, it has introduced some additional clarity by leveraging the definitions contained in existing domestic legislation, relating to the meaning of "tax advantage" and "arrangements". The Bill also sets out the penalty regimes applying to any failure to comply with the obligations set out in the reporting regime.

While these clarifications are welcome, considerable uncertainty remains with respect to the correct application and interpretation of the rules, given the ambiguity included within the DAC 6 Directive itself.

Consequently, the content of the supplementary guidance notes that we expect to issue in 2020 will be very important in aiding the interpretation and application of the rules in an Irish context. In the meantime, given the DAC 6 Directive will now be on a statutory footing and has effect from 25 June 2018, it is important that all relevant transactions are assessed and documented by reference to the wording contained within the Bill. This will be a very significant exercise for a number of FS companies, who may have reporting obligations both as a taxpayer and as an intermediary.

Additional Measures relevant to FS

Additional Tier 1 Capital

Under the revised definition, any instrument which satisfies the equivalent conditions of an Additional Tier 1 instrument under Article 52 of the Capital Requirements Regulation but which has not been issued by a regulated entity, will be treated in accordance with Section 845C. This amendment will have no impact on existing Additional Tier 1 instruments.

Bank Levy

As announced in the Budget, the rate of the Bank levy is increased in the Bill from 59% to 170%. This measure, which is effective for payments due in 2019 and subsequent years, has been introduced in order to maintain the tax raised at a level of €150 million.

Investment Limited Partnership

The Bill introduces welcome amendments to the provisions for the taxation of Investment Limited Partnerships (“ILPs”). The changes amend terminology in the existing legislation which has the effect of providing that the income, gains and losses of the partnership are treated as arising or accruing to each partner in the partnership in proportion to their share in the partnership. These changes apply to ILPs authorised on or after 1 January 2020.

Extension of relief for independent financial agents

The Bill extends the provisions precluding overseas investment funds from falling within the scope of the Irish tax by virtue of appointing an Irish independent authorised agent. These provisions have been extended to reflect updates to the regulatory provisions by including firms regulated under MiFID Regulations by the Central Bank of Ireland and branches of such entities regulated in other Member States.

Stock Lending and repurchase transactions

The existing practice in respect to stock lending and repurchase agreements has been put onto a statutory footing. The new provisions, subject to anti-avoidance measures, will tax such transactions based on their substance as a lending transaction, as opposed to the legal form, being a disposal and acquisition of the securities in question. In keeping with the existing practice, the provisions are restricted to arrangements not exceeding 12 months.

Irish finance bill 2019 – what does it mean for financial services? (cont.)

Deductibility of tax on income

The Bill contains a provision which disallows a deduction for "any taxes on income" as a trading deduction under general tax principles. This puts the long-standing Irish Revenue view onto a legislative footing. In an FS context, this will impact taxpayers who incur a tax on income and cannot claim relief under the existing double tax relief rules. Any companies taking a tax deduction for foreign tax suffered will need to consider this provision in detail.

Doubtful Debts

A statutory definition of bad debts, specifically "doubtful debts to the extent that they are respectively estimated to be bad", has been inserted, which, for companies, aligns the existing allowable statutory deduction with impairment losses, as calculated under GAAP.

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The life insurance protection gap: is auto-enrolment the answer?

When addressing how to close the life insurance protection gap, could people simply need a nudge in the right direction? A quick look at similar efforts to address organ donation, which also faces a challenge around take up, could hold the beginnings of a solution.

A 2003 academic paper, called 'Do Defaults Save Lives' by Eric J. Johnson and Daniel Goldstein of Columbia University examines the impact of so-called policy defaults on an individual's decision to become an organ donor. The pair demonstrated that in countries where organ donations are the default, meaning that people must actively opt out if they don't want to donate their organs after death, donation rates are significantly higher than in countries where this is not the case.

The findings might not surprise you. It's well-known that humans in many cases are conditioned to choose the path of least resistance. But it's nonetheless a powerful example of Nudge Theory; the theory that positive reinforcement can influence behaviour and decision-making. This concept prove relevant to the insurance industry.

Why don't people buy life insurance?

We recently conducted a survey of 1000 nationally representative adults, to better understand the public's attitude towards life insurance. One of the most striking things we found was that 50% of respondents had never bought life insurance. This includes 21% of people who had considered buying life insurance in the past, but hadn't taken it out, and a further 29% had never considered buying it. That encouraged us to understand better what the main barriers are to buying life insurance and what can be done to help the public to overcome those barriers.

Cost, or rather the perception of cost, emerged as one of the main reasons why people decided not to buy life insurance. The respondents over-estimated the cost of buying life insurance significantly, thinking that £100,000 of life cover might cost on average £40 per month, instead of the c£10 per month cost that might be closer to reality. A lack of financial literacy also put people off. This underscores a desperate need for greater education on money matters, particularly at the younger end of the spectrum for those aged 18-34.

Whilst an improved financial education would increase awareness of insurance, life insurance remains a difficult subject to discuss at the dinner table. We think more direct action could help to break this taboo, improving the financial resilience of the 16m households without life protection insurance in the UK today.

So what might be the answer? If the Nudge Theory mentioned above were put into practical action, one answer might be to include life insurance benefits inside the auto-enrolment model that has been so successful in helping more people save for their pension. From our survey, we know that two thirds of the population would opt to stay in an arrangement where life insurance was automatically offered. As with pensions, there could still be a choice to opt-out, but the majority wouldn't opt out – and in one stroke, the financial security of so many families would be improved. This is not a new idea – other countries already have something similar – so why not in the UK too?

Encouraging people to get covered

With Brexit currently absorbing much of politician's thinking time, however, it might be difficult to make progress on this idea too quickly. So what else might help?

Help at the time of purchase – we know from our survey that the internet is often the first place many turn if they are thinking of buying life insurance. But we also know from speaking to insurers that only maybe 3 in every 100 people who start the process of purchasing life insurance online actually buy. Why is that?

We think psychology is at play here and could at least partly be overcome by effective use of technology. Anchoring – where an individual depends too heavily on an initial piece of information when making decisions – is a key influence. On a day-to-day basis, many would spend £10 without thinking too much about it – a couple of drinks in the pub, a bit of shopping on the way home from work barely registers. However, when considering whether to spend £10 per month buying life insurance, purchasers often concentrate on the larger number – the £100,000 of cover and whether that is the right amount of cover to take – rather than the £10 per month purchase cost that they are buying into. By getting hung up on that question, they fail to purchase at all, leaving them financially vulnerable.

The long term description of the products also puts people off – they feel like they are signing up for 25 years of premium payments with no way out if their circumstances change. In reality, for most people cover can commence immediately, and can be simply cancelled at any point without penalty. This makes the decision to take life insurance less onerous than a 12 month mobile phone contract, or a TV subscription, but this is not readily understood by consumers.

The life insurance protection gap: is auto-enrolment the answer? (cont.)

Is technology the answer? If during that online purchase, some real time and real-person online help were available, could that increase the take-up rates? And by help we don't mean 'advice'. Advice is a loaded concept in the financial services space, it comes with many connotations of salesmen, paperwork and commission. We just mean help – it might be help in understanding some terminology, help in understanding the process and what happens next – enough help to push the person through to the conclusion of actually purchasing the insurance.

We know there are Insurtechs operating in this space, but the large established insurers came out as a clear favourite as the 'provider of choice' in our survey. So it is they who have the most to gain by taking action now – and most to lose if they stand still.

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Portuguese Stamp Tax: new monthly statement requirements published

Portugal has issued new Stamp Tax reporting obligations for banks and insurance companies, which will come into force on 1 January 2020.

Although the stamp duty itself, due on loans, insurance premiums and commission for financial services is the responsibility of the borrower/policyholder, payment and reporting of any tax due to the Portuguese Tax Authority is the responsibility of the lender/insurer/financial service provider. As such, banks and insurance companies need to be aware of the new regulations.

Decree no. 339/2019, published in the Official Gazette of 1 October, approved a standard form of the monthly Stamp Tax Statement.

Entities required to assess Stamp Tax on their operations or in the operations in which they intervene, even if all the operations concerned are exempt, are now required to file monthly Stamp Tax statement electronically by the 20th of the following month.

The main information to be included in the statement is as follows:

- identification of the tax basis;
- identification of the tax charged per entity;
- regarding stamp tax exempt transactions, identification of the tax basis per entity and provision in the law that grants the exemption;
- indication whenever the tax has been assessed by a tax representative in Portugal, as is the case for non-resident banks and non-resident insurance companies that operate in Portugal under the free provision of services regime.

A payment reference will be issued after the submission of the statement.

This new monthly statement also needs to be filed by non-resident banks and non-resident insurance companies that operate in Portugal under the free provision of services regime, through their tax representatives in Portugal. Since Stamp Tax only applies to investment funds and collective investment vehicles that are ruled by Portuguese law, this new statement does not impact on non-resident investment funds and collective investment vehicles.

The Decree enters into force on 1 January 2020, however it is expected that the first submission will not be required until 20 February 2020 (although this has not been officially confirmed yet).

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PRA Consultation Paper 26/19 - restricted Tier 1 convertible debt

In brief

Following discussions with HMRC the PRA has published a consultation paper (CP 26/19) on 11 October 2019 in relation to the treatment for regulatory purposes of restricted Tier 1 Capital.

Currently, the PRA expects that insurers would deduct the maximum tax charge for Solvency II purposes where a restricted Tier 1 Capital instrument may be written down. The new proposal from the PRA, included in the consultation document, is that this deduction should also apply for certain instruments which convert into equity.

The PRA have been considering the tax treatment of these instruments since the repeal of the "Regulatory Capital Securities Regulations" and their replacement with the "Hybrid Capital Instrument" rules. These new rules no longer include a blanket exclusion for credits arising on a write down or conversion of such regulatory instruments.

Following discussions with HMRC the PRA believes there is sufficient uncertainty over the tax treatment of these instruments in certain circumstances to justify an adjustment in Solvency II.

In detail

HMRC has recently drawn the PRA's attention to its conclusion that where a restricted Tier 1 instrument has a "conversion share offer" (CSO), which is drafted in such a manner that there is an option for the issuer to compel the noteholder to sell the shares issued, any credits arising on conversion may be taxable.

HMRC's reasoning for this that the exercise of this option may mean that the release of debt is not in consideration for shares (non taxable) but instead for cash (taxable).

The proposal from the PRA is that for the calculation of the loss absorbency of capital for Solvency II purposes the expectation is that such convertible instruments with CSO clauses should include a haircut to represent the maximum possible tax charge.

The proposed maximum tax charge generated on conversion is to be calculated as the instrument's face value (adjusted for any minimum CSO price per share value) multiplied by the prevailing corporate tax rate.

However, to the extent that an "independent tax opinion from an appropriately qualified individual" is provided stating that "no tax will be payable on trigger" at least 30 days before the issuance of these instruments this haircut should not be required.

Where firms have already issued external restricted Tier 1 convertible instruments with these clauses it is expected that "grandfathering" may be available but this will need to be discussed with the PRA on a case-by-case basis.

Impact for Insurers

The consultation paper is relevant to UK insurance firms within the scope of Solvency II, the Society of Lloyd's, and firms that are part of a Solvency II group. We would recommend that groups in this position consider the proposals set out in this consultation paper, and in particular where there is any current or planned issuance of restricted Tier 1 Capital including such a "CSO" clause.

The requirements of this PRA proposal remain uncertain as it is not clear who would be viewed as an "appropriately qualified individual" or what strength of opinion would be deemed to be acceptable.

The PRA consultation on these proposals continues until Monday 13 January 2020. Please feel free to contact us if you have any queries, or if you are interested in responding to the consultation.

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