

Controlled foreign company rules and the global minimum tax

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Groups whose parent company is resident in a country with controlled foreign company rules must also ask whether the profits of a captive abroad will be taxed at home. Germany provides a typical example. Under the Foreign Tax Act, the low-taxed passive income of a foreign company controlled by German residents is added to the income of the German shareholders. The threshold of low taxation was set at twenty-five per cent and was reduced to fifteen per cent from 2024. Insurance income is treated as active only under conditions that captives usually fail to meet, because a captive earns most of its income from risks of related parties.¹ A German group with a Swiss captive taxed at about twelve or thirteen per cent therefore faced an add-on taxation in Germany for many years, which explains why German groups tended to place their captives in Luxembourg, where the equalisation reserve postpones the tax, or kept them in Germany. Since Switzerland itself has no controlled foreign company rules, the Basel groups are not affected in the same way by the captives they own abroad.

The European Union required all member states to introduce controlled foreign company rules through the Anti-Tax Avoidance Directive of 2016, which takes a similar approach to insurance income. The United States has applied its own rules on the income of offshore captives since the Subpart F legislation of 1962, supplemented in 2017 by the tax on global intangible low-taxed income and by the base erosion and anti-abuse tax, which reaches certain reinsurance premiums paid to foreign affiliates.² The application of these rules to captives is an example of the way in which tax law has narrowed the room for the tax-driven placement of risks.

The global minimum tax under Pillar Two has narrowed it further. Switzerland introduced a qualified domestic minimum top-up tax from 1 January 2024, after the constitutional amendment approved by the people

in June 2023, and the income inclusion rule from 1 January 2025. Large groups with consolidated revenues of at least 750 million euros must pay at least fifteen per cent on their profits in each jurisdiction.³ A captive of a Basel group in Zug or Basel is therefore taxed up to fifteen per cent, while a captive in Bermuda is subject to the corporate income tax that Bermuda introduced from 2025 in response to Pillar Two.⁴ The GloBE rules contain special provisions for insurance, among them rules on the treatment of insurance reserves and the investment income of insurers. The Luxembourg equalisation reserve has become less attractive for groups within the scope of Pillar Two, because its deduction may reduce the effective tax rate below the minimum and trigger a top-up tax. For the large groups of Basel, the decision to keep or to establish a captive now rests almost entirely on its risk management function.

1 Notes

1. Außensteuergesetz (AStG), §§ 7–8, as amended by the ATAD Implementation Act (ATAD-Umsetzungsgesetz) of 25 June 2021, in particular § 8(1) no. 3 AStG on income from insurance undertakings and § 8(5) AStG on the low-tax threshold (25 %, reduced to 15 % by the Act on the Implementation of the Minimum Tax Directive of 21 December 2023). To be verified. ↩
2. Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices (ATAD), Art. 7(2)(a)(iv) (income from insurance, banking and other financial activities); on the United States rules, see Subpart F (26 U.S.C. §§ 951 ff.), the GILTI and BEAT provisions introduced by the Tax Cuts and Jobs Act of 2017 and their subsequent amendments. Status to be verified. ↩
3. Federal Decree on a Special Taxation of Large Corporate Groups (implementation of the OECD/G20 Project on the Taxation of the Digital Economy), approved in the popular vote of 18 June 2023 (Art. 129a Cst.), and the Minimum Taxation Ordinance (MindStV, SR 642.161), with the QDMTT applying from 1 January 2024 and the IIR from 1 January 2025; the UTPR has been postponed. Status to be verified. ↩

4. Corporate Income Tax Act 2023 (Bermuda), imposing a 15 % corporate income tax on Bermuda constituent entities of multinational groups with annual revenues of at least EUR 750 million, effective for fiscal years beginning on or after 1 January 2025. To be verified. ↩

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