

9 January 2015

GFIA Comments on OECD Discussion Draft on "BEPS Action 7: Preventing the Artificial Avoidance of Permanent Establishment (PE) Status"

Introduction

The Global Federation of Insurance Associations (GFIA) through its 38 member associations represents insurers that account for around 87% or more than \$4 trillion in total insurance premiums worldwide. GFIA is pleased to provide comments on the OECD discussion draft on "BEPS Action 7: Preventing the Artificial Avoidance of PE Status". In general, we support the objectives of the OECD BEPS Action Plan to address weaknesses in the international tax environment. Accordingly, we support the broad objectives of the discussion draft in combating aggressive tax planning aimed at preventing the artificial avoidance of Permanent Establishment ("PE") status. However, it is critical that any measures adopted by the OECD are workable, well targeted, and do not result in unintended consequences that negatively impact the efficiency of commercial insurance operations and the availability and cost of insurance coverage for consumers.

Our key comments are as follows:

- **Insurance Specific Provision (Option M):** We do not believe there is a need for a specific provision that applies to insurance and the collection of premiums by an agent as outlined in Option M. Any discussion about the taxation of the insurance industry and any perceived BEPS issues needs to consider the highly regulated environment in which the insurance industry operates, which prevents insurance agents from concluding insurance contracts, and the critical role of risk and capital, as well as the impact of insurance premium taxes. Any perceived issues would be more appropriately considered as part of the discussions on transfer pricing under Action 9, rather than as part of the PE discussion draft.
- **Commissionaires Arrangements & Options A-D:** We understand the OECD's desire to address the artificial avoidance of PEs through the use of Commissionaires arrangements. However, we are concerned that the four options for revising the wording of Article 5 are very broadly worded which could have significant unintended consequences for commercial insurance operations.
- **Need for Guidance:** It is critical that clear guidance is provided for any changes to the wording of Article 5, to define the key terms and provide detailed examples of the precise situations that are caught and those that should be excluded. Otherwise, there will be uncertainty for business, an increase in disputes and an increased risk of double taxation.



Insurance Specific Proposal (Option M)

We do not believe there is a need for a specific provision for insurance and the collection of premiums by an agent as outlined in Option M. Under Option M, agents who collect premiums, but do not perform the Key Entrepreneurial Risk-Taking (KERT) function of assuming insurance risk/business¹, would, if not sufficiently independent, create tax PEs. Since the agents are third parties, they should already be fairly compensated on an arm's length basis and subject to tax on that income in the jurisdiction in which they operate. Accordingly, any deemed PEs would have no or minimal additional profit attribution, and, any additional taxes would be non-existent, or minimal at most.

Deemed PEs would result in a disproportionate compliance burden, since PEs would be created for tax purposes, even though there is no PE for regulatory purposes. Given the highly regulated nature of the insurance industry, it makes sense to continue the current alignment of tax and regulatory reporting, which results from the fact that the current definition of PE for tax and regulatory purposes is quite similar. Lack of alignment, as under Option M, would put a disproportionate compliance burden on insurers (requiring tax returns to be completed and profit attribution calculations etc) without much, if any, additional tax.

The collection of premiums alone does not necessarily create value for the insurer. The 2010 OECD Report on the Attribution of Profits to Permanent Establishments Part IV (Insurance) ("Part IV") notes that sales and marketing is only one of the functions in the insurance value chain. Paragraph 117 of Part IV recognizes that if the person (i.e. agent) collecting the premiums does not make the decision to accept the risks/business associated with the insurance policy, then the collection of premiums does not mean that insured risks/business have been accepted by that person. This is an important point since, as recognised under Part IV, the KERT for insurers is the assumption of insurance risk/business (see for example paragraphs 93² and 94). Accordingly, the KERT function rests with the entity which accepts and manages the risk/business (ie. the insurer and not the agent). Therefore, under Part IV, all or nearly all of the profit will be attributed to the insurer's country of residence, even if there is a deemed PE by virtue of the agent's collection of premiums. However, to the extent any income is attributed to a deemed PE, it will result in double taxation, unless the home state provides relief.

¹ Per the 2010 OECD Report on the Attribution of Profits to Permanent Establishments Part IV (Insurance).

² Paragraph 93 of Part IV states in unequivocal terms:

All facts and circumstances need to be considered to determine which function assumes insurance risk for the enterprise, because the assumption of insurance risk is the key entrepreneurial risk-taking function for an insurance enterprise. Other functions performed by an insurance enterprise may be important and valuable functions and should be compensated accordingly, but these other functions are not functions that form part of the key entrepreneurial risk-taking function.



In addition to taxes paid by the agent, many countries have an Insurance Premium Tax payable by a non-resident insurer on gross premiums for risks insured that are situated in that country. When this premium tax and the tax paid by the agent on the fee are taken into account, it can be seen that there is already a sufficient tax burden where risks are insured in a country where an insurer does not have a PE.

Deeming a PE in a jurisdiction solely on the basis of premium collection is clearly inconsistent with the regime that governs the international trade in tangible goods. It would be equivalent to deeming a PE in every jurisdiction where a manufacturer's goods are sold, even if there was no material nexus with that jurisdiction. If an insured person moves from country A to country B and the insurer facilitates premium remittances for that individual by accepting payment at a facility maintained in country B by the insurer's affiliate that carries on a non-insurance related activity, a PE would result, even if that was the only person insured by that insurer in that country. The collection of premiums seems quite far from the minimum threshold required for a tangible goods vendor to be considered as having a PE in a jurisdiction.

Accordingly, we do not believe there is a need for a specific insurance provision as outlined in Option M.

Commissionaires Arrangements & Options A-D

As noted above, we are supportive of any appropriately targeted measure adopted by the OECD to address the artificial avoidance of PEs through Commissionaire arrangements. However, the options as currently drafted are overly broad, which will result in differing interpretations by local tax authorities and uncertainty for business, with the possibility of costly disputes for businesses and double taxation. Any changes should therefore be more focused on preventing the specific avoidance and should not impact ordinary commercial business structures. One way to accomplish this would be to provide sufficient guidance as to the types of transactions that are caught and those that are not.

The Discussion Draft indicates that Commissionaire and similar arrangements "were put in place primarily in order to erode the taxable base of the State where sales took place". This is not true in the highly regulated insurance business. Insurance agents are not Commissionaires. Regulatory restrictions prevent insurance agents from concluding insurance contracts. This is because insurance agents are not subject to prudential solvency and capital requirements since the agent does not assume the insurance risk. Insurers are highly regulated - they require a licence to sell in a particular jurisdiction and are subject to market conduct regulations (as are agents). Insurers are subject to prudential regulations in jurisdictions where risks have been insured/assumed requiring risk management frameworks and sufficient regulatory capital to cover those risks. Prudential regulation is only required where there is a real transfer of risk. In addition to these regulatory requirements which do not apply in Commissionaire arrangements, the nature of the contracts is also substantially different, with performance occurring in the home jurisdiction in the case of insurance (ie. where the insurer decides whether to assume the risk and if so, manages the risk etc) as compared to the local or host jurisdiction (ie. where the products are delivered) in Commissionaire arrangements.

Specific concerns for these options are as follows:

- **Option A:** This option replaces the words "concludes contracts" in the existing model tax treaty with "engages with specific persons in a way that results in the conclusion of contracts". This wording is overly broad which would result in significant uncertainty and a risk that different jurisdictions would take different interpretations, leading to disputes and potentially double taxation.

In the insurance operating model, agents, brokers and independent financial agents are vital as they introduce clients to insurers. It could be viewed that the agent's engagement with the client results in the conclusion of the contract. However, insurance agents do not conclude insurance contracts due to insurance regulatory restrictions which prevent them from accepting insurance risk since they are not a regulated insurer, NOT because of seeking to avoid having a PE. Insurance agents also do not have the capital at risk nor do they bear the risk of loss under the contract. The agent receives an arm's length fee commensurate with the services provided. Furthermore, the vast majority of insurance agents are third party brokers and so the commissions are negotiated between third parties.

If Option A is adopted, guidance should clearly indicate that regulated insurance agents, brokers and independent financial agents will not be considered to "engage with specific persons in a way that results in the conclusion of contracts".

- **Option B:** This option refers only to "negotiating the material elements of contracts". We believe the wording would be more precise if the word "elements" was replaced with "terms". Clear guidance would be needed to ensure there is consistency in how the words are interpreted by different tax authorities. This guidance should be linked to insurers' key activities as set out in Part IV. Without this, there is a risk that different jurisdictions would have a different interpretation leading to disputes and potentially double taxation.
- **Options C and D:** add the words "contracts which, by virtue of the legal relationship between that person and the enterprise, are on the account and *risk* of the enterprise" (*emphasis added*). This wording would have unintended consequences where "risk" is the business, as is it is for insurance. Quota share reinsurance³ could fall within this wording since the contract is partly "on the account and risk" of the quota share reinsurer "by virtue of the legal relationship" (i.e. treaty) between the direct writer and reinsurer. Quota share reinsurance is a common form of reinsurance which is undertaken

³ Quota-share reinsurance and co-insurance are common types of proportional reinsurance whereby the reinsurer reinsures a certain percentage of each of the policies written by the ceding company. Once the reinsurance treaty is entered into, the reinsurance is automatic. One reason for such treaties is if the ceding company does not have sufficient capital to retain all the business it can sell. For example, by reinsuring 50%, it can write twice as much business. The ceding company may also use reinsurance to limit its exposure to risks it has written.



for commercial reasons, including risk and capital management. Quota share reinsurance should not create a PE for the reinsurer in the territory of the direct writer, which should be clarified in guidance if options C or D are adopted.

Dependent Agent Threshold

All of the Options A-D propose amendments to paragraph 6 of Article 5 to strengthen the requirement of independence by excluding an agent, including an unconnected 3rd party, who “acts exclusively or almost exclusively [...] on behalf of associated enterprises”. This could result in the creation of numerous inappropriate PEs in a number of situations such as:

- Where a related party has little or no third party business of its own. For example, a group parent company could negotiate outwards reinsurance contracts on behalf of the whole group, with all operating entities being covered under the same global contract, which could result in PEs being created for all the operating entities.
- A group's service companies may have the authority to bind multiple insurance operating entities to procurement or service contracts (e.g. outsourcing for IT, claims management, or call centres; investment management or purchasing office supplies etc). The service companies would likely earn all their income from, and all of their activities would be for, related parties. Numerous PEs could be created which would create a disproportionate compliance burden for little or no additional tax.

GFIA contact

Peggy McFarland, chair GFIA Taxation Working Group, pmcfarland@chia.ca

About the GFIA

Through its 38 member associations, the Global Federation of Insurance Associations (GFIA) represents the interests of insurers and reinsurers in 58 countries. These companies account for around 87% of total insurance premiums worldwide. The GFIA is incorporated in Switzerland and its secretariat is based in Brussels.