GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

15 April 2024

GFIA's comments on the proposal for an insurance provision in the UN Model Convention

1. Summary

1.1. Pursuant to the discussions held at the 28th session of the Committee of Experts on International Cooperation in Tax Matters (hereafter the 'UN Tax Committee'), GFIA welcomes the opportunity to provide further comments on the workstream of the Subcommittee on the United Nations Model Double Taxation Convention (hereafter ''the UN Model Convention').

1.2. After a proposal to introduce modifications to articles 5 and 7 of the UN Model Convention, the Subcommittee presented at the 28th session of the UN Tax Committee a new approach to address the treatment of income from cross-border insurance activities. This report suggests the introduction of a new article 12 C relating to insurance and reinsurance cross-border activities.

1.3. GFIA acknowledges that the Subcommittee on Taxation Issues Related to the Digitalized and Globalized Economy excluded insurance from the scope of the new article on fees for services proposed for introduction, as cross-border insurance would be addressed by specific provisions.

1.4. Under this new article 12 C, insurance premiums would be taxed in the state of residence of the payee. It would also allow the state of residence of the payer, or the state in which a permanent establishment that makes the payment is situated, to tax insurance premiums at a rate that shall not exceed an agreed percentage of the gross amount of the insurance premiums. The draft commentary contains an optional alternative under which the state in which an insured risk is situated may tax the premium in certain circumstances.

1.5. According to the Co-Coordinators' Report (E/C.18/2024/CRP.11), the stand-alone article 12 C will be submitted for approval during the next session, the 29th session.

2. General comment

2.1. The Co-Coordinators' report on the treatment of income from cross-border insurance activities (E/C.18/2024/CRP.13) sets out the proposed approach to address the concerns of some States that consider insurance as a highly mobile industry. On that matter, GFIA would like to highlight that insurance is a highly regulated industry that requires compliance with local regulations including local regulatory capital detention to match local risks.

2.2. Moreover, insurers have to stay close to their customers (insureds) given the type of insurance coverage provided (protection, general insurance, life insurance). That is why insurance cannot typically be carried out without any physical presence in the country where the risk lies[1]. In most instances, physical presence qualifies as a permanent establishment. The report unfairly describes some features of the industry such as providing insurance through independent agents, reserving regulation or the underwriting of reinsurance policies as potential risks of profit shifting and/or base erosion.

Insurance cannot be analysed as a passive activity whose income is commonly subject to withholding tax under double taxation conventions, such as dividends, royalties, or interest payments. It is a specific line of services business requiring an estimate of future costs to determine the premium, because

[1] There is an exception with the mechanism of freedom of services in Europe as provided for under articles 56 and 57 of the Treaty on European Union and the Functioning of European Union. In such cases, the insurer must be licensed in one of the Member States to provide coverage in other EU countries. As regards to taxation, directive 2009/138/EC on the taking-up and pursuit of the business of insurance and reinsure provides in article 157 that "*without prejudice to any subsequent harmonisation, every insurance contract shall be subject exclusively to the indirect taxes and parafiscal charges on insurance premiums in the Member State in which the risk is situated or the Member State of the commitment*".

Global Federation of Insurance Associations (GFIA)

Secretariat : rue du Champ de Mars 23, 1050 Brussels, Belgium

Tel : +32 2 894 30 81 E-mail : secretariat@GFIAinsurance.org

www.GFIAinsurance.org

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insurers collect premiums first and pay expenses later over the duration of the coverage (general expenses, claims). This means that gross premiums are not a measure of the insurer's actual profit or loss for a given line of insurance business.

Moreover, insurers' profits are usually taxed where the risks lie, through indirect taxes on premiums and/or corporate income taxes on the branch operating in the country.

2.3. As for reinsurance, the report also describes some technical features of the industry thus acknowledging that reinsurance is insurance for insurers but concludes that shifting risks to a reinsurer is a way of shifting profits, especially if it is a related company.

Reinsurers are essential to keep the insurance industry sustainable by providing access to larger capital pools and helping primary insurers diversify their risk. The diversification of risks avoids the concentration of exposure to a single event or series of events, reducing unnecessary capital drain on any one company. This is true for both third-party and intragroup reinsurance. Furthermore, a reinsurer may reinsure to affiliated companies to facilitate effective global management of capital and efficiently pool the risk. Notably, it is common for a U.S.-based reinsurer to reinsure to an offshore affiliate that is also a U.S. taxpayer.

Reinsurers pool and diversify the risk of primary insurers on a larger scale to mitigate possible losses. Reinsurers contract with the primary insurer (or cedant) to reimburse any future claim the primary insurer might have against the payment of a premium today. Reinsurance (including intragroup reinsurance) is therefore regulated under similar rules as those applicable to insurers and reinsurers report to similar supervisory bodies at domestic and international levels. In some jurisdictions, reinsurers are required to provide guarantees (cash deposit, asset pledging, letters of credit) before entering a reinsurance arrangement with local insurers.

Moreover, writing reinsurance entails capital flows both ways: reinsurers receive premiums including a margin for risks reinsured and insurers receive a significant commission (ranging from 10% to 30%) compensating for the primary insurers' policy acquisition costs. For reinsurance also, the gross premium is determined by an estimate of the risk underwritten and is not an actual profit.

2.4. The purpose of a tailored article on insurance is therefore to enable the taxation of insurance and reinsurance premiums in instances not addressed by the provisions under article 7 of the UN Model Convention on business profits, that are applicable where there is recognition of a deemed permanent establishment or of a business activity of similar kind. To respond to what seems a wish for simplicity, the report envisages taxing premiums on a gross basis rather than determining an actual measure of profit.

The drafting of the proposed article 12 C raises issues on which GFIA appreciates the opportunity to provide feedback:

- The definition of "insurance premium"
- The definition of "beneficial ownership"
- The location of risk
- The taxation on a gross or a net basis.

3. Comments and concerns

3.1. Definition of insurance premiums in draft article 12 C (3)

The draft commentary of the proposed article 12 C (3) defines insurance premiums as "*amounts paid to an insurance enterprise pursuant to a contract (policy) in which the insurance enterprise indemnifies another person against losses from specific contingencies or perils (risks)*".

This definition includes all payments made to undertakings meeting the definition of an insurance enterprise as referred to in paragraphs 28 and 29 of the draft commentary. There is no specific definition of an insurance enterprise in the report, but the commentary seems to refer to domestic regulation to include any company "*viewed as issuing "insurance" under a country's domestic law* ".

All payments received by undertakings meeting the criteria of an insurance enterprise under domestic regulation are therefore in the scope of draft article 12 C (3).

This definition needs some further clarifications, especially about the term “insurance enterprise” to give more clarity to the scope of insurance premiums.

Indeed, it is not clear whether the definition would cover life insurance premiums that include an investment element. In this case a proportion of the premium paid therefore represents a deposit of money rather than a payment for services provided. This therefore disqualifies the premium as a valid proxy for profit as it will reflect the capital investment component as well. Furthermore, implementing a withholding tax on such life premiums will have direct impact on the policyholder, as the insurer will likely mirror the tax burden on the premium charged. Under such circumstances, a tax on the provision of cross-border insurance should not tax investments which take the form of life policies.

3.2. Introduction of the beneficial ownership of premiums

Proposed article 12 C (2) introduces the notion of beneficial ownership of premiums for the purpose of determining the actual recipient of the premiums. The beneficial owner as considered in the draft article 12 C and draft commentary (paragraphs 19 to 21) must be distinguished from other references to that notion. The draft commentary refers to the beneficial owner as being the person who has “*the right to use and enjoy the premiums unconstrained by a contractual or legal obligation to pass on the premiums received to another person”.*

However, the draft commentary considers that an insurer may not be the beneficial owner of premiums which it receives if it cedes some or all of the business by way of reinsurance. This does not seem right in principle and would give rise to significant difficulties in practice. Unlike recipients of interest or dividends, an insurer takes on obligations to its policyholders which it has to meet itself whether or not its reinsurance responds to claims, and the policyholders do not have any right to indemnification from the reinsurer. Moreover, an insurance company carries out an active trade including acquiring and underwriting policies and handling claims, which is far removed in nature from the sort of conduit company to which the draft commentary refers.

On a practical level, if identifying the beneficial owner of the premium entails “looking through” reinsurance policies also, then the proposed provision would in most circumstances be unworkable. As outlined in the co-coordinators’ report, reinsurance can take several forms. In the case of non-proportional reinsurance for instance, there is no direct link between the premiums received by the insurer and the premium paid under the reinsurance contract as an excess-of-loss insurance only covers risks above a certain threshold. This makes it almost impossible to determine the beneficial owner of the premiums collected by the primary insurer. Moreover, reinsurers often constitute a reinsurance programme by ceding lines of business to other reinsurers which in their turn do the same, making it difficult or impossible to determine the actual beneficial owner of the premium paid to the primary insurer. There are other ways to address treaty shopping such as anti-avoidance or conduit rules.

3.3. Issues arising from the location of risk

Article 12C (5) provides for a payment rule which considers that premiums arise in the jurisdiction where the payer is a resident or has a permanent establishment. In the case of an insurance policy covering risks in multiple jurisdictions, some members are concerned that the payment rule may fail in some instances such as those described in paragraph 39 of the draft commentary, to enable the taxation of insurance premiums in jurisdictions where the risks are located.

Some members of the Committee thus proposed to add a subparagraph (b) to consider the premium to arise in the jurisdiction where the risk lies, rather than in the state of the residence or of a permanent establishment of the payer.

However, determining the location of a risk insured by an insurance policy is difficult. This would lead to double taxation as domestic laws are unlikely to be wholly aligned on the location of risks and especially so concerning reinsurance. Furthermore, determining the location of an insured risk is a complex task that could create a disproportionate administrative burden for both taxpayers and authorities. Indeed, the task would entail comparing location of risk provisions under relevant domestic laws, bilateral tax treaties applicable and even specific provisions, where available, in the insurance or reinsurance contracts.

For example, double taxation could occur if country A taxes premium payment paid by an individual in country A for a policy of their relative, who lives in country B. If country B is the U.S., then the premium payment would be subject to tax in country B pursuant to the US excise tax and also subject to tax in country A.

It is common for a global company to purchase a global employee benefit policy for its global workforce, and then the tax is collected where the purchaser is located, even if the cost is allocated to affiliates in different jurisdictions. Alternatively, imposing a tax based on the location of risk may work for direct insurance (although shipping, airlines, and other mobile risks present challenges) while it is often impossible to identify the location of risk in reinsurance. In this case, considering the risk to be located in the state where the reinsurer is established might be a workable idea. If the idea is to track the underlying risk as mentioned in paragraph 40 of the draft commentary, then identifying the primary risk would be impossible, especially if the risk has been reinsured multiple times or under an excess-of-loss reinsurance contract.

It is challenges presented by the insurance and reinsurance business model that have led to the exclusion of insurance and reinsurance as a regulated financial service from the scope of Amount A under the Pillar One of the rules adopted by the OECD/G20 Inclusive Framework. It is not possible to impose a tax without creating undue harm to a critical risk management industry.

3.4. Taxation on gross premiums

Article 12 C would allow a contracting State to levy a withholding tax on all premiums collected locally except in instances where insurance is provided through a permanent establishment. In the latter case, as provided for under article 12 C (4), article 7 of the UN Model Convention would be applicable to tax the net profits attributable to those permanent establishments.

As mentioned above, the core feature of insurance and reinsurance is an inverted production cycle, meaning that income (premiums) is received before expenses arise. The insurer cannot determine whether contracts written for a specific class of insurance are profitable until the cycle of the coverage is completed, which in some classes of business takes 15 to 30 years.

Although taxing gross premiums may seem the easiest way to collect taxes in the source state, gross premiums cannot serve as a valid proxy for profits since the actual profit of the insurer or the reinsurer, if any, may be considerably lower. There is also a risk of double taxation on the same insurance risk through the application of a withholding tax on gross insurance and reinsurance premiums.

In fact, a withholding tax may raise the overall tax burden of insurers if it cannot be fully credited against the tax liability of the insurance or reinsurance company, e.g. because of low profits or losses. This could therefore lead to an increase of the cost of insurance for the insureds locally.

GFIA thanks the Subcommittee on issues related to the UN Model Double Tax Convention for considering the concerns expressed above. For more details on some of the issues highlighted in this paper and more, the Subcommittee can refer to papers submitted by GFIA member associations. GFIA looks forward to engaging further in the important discussions that lie ahead about the proposal.

Contacts

Suzy Zozor, Chair, Taxation Working Group (s.zozor@franceassureurs.fr)

GFIA secretariat (secretariat@gfiainsurance.org)

About GFIA

The Global Federation of Insurance Associations (GFIA), established in October 2012, represents through its 42 member associations and 2 observer associations the interests of insurers and reinsurers in 70 countries. These companies account for 89% of total insurance premiums worldwide, amounting to more than $4 trillion. GFIA is incorporated in Switzerland and its secretariat is based in Brussels.