GFIA
GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

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GFIA comments on the UN Co-Coordinators' Report on the treatment of income from cross-border insurance activities

1. Summary

1.1. The Subcommittee on the United Nations (UN) Model Double Taxation Convention between developed and developing countries issued a report on the treatment of income from cross-border insurance activities. The report suggests modifying the UN Model Convention by deleting paragraph 6 under article 5 (which creates a deemed permanent establishment) and introducing a paragraph 6 under article 7 (which would allow taxation of the relevant premiums on a gross basis). The Subcommittee also suggests a draft commentary to explain the modifications.

1.2. GFIA acknowledges receipt of the co-coordinators' report on the treatment of income from cross-border insurance activities, including reinsurance, as discussed during the 27th session that took place in Geneva from 17 to 20 October. GFIA welcomes the opportunity to share feedback from the industry on this report and the proposal for the modifications and clarifications entailed by the report.

2. General comment

2.1. With this proposal, the Subcommittee on UN Model Convention shifts the rationale for the taxation of income deriving from cross-border insurance activity from the existence of a permanent or deemed permanent establishment to the collection of premiums in a given jurisdiction.

2.2. The current provision under article 5 allows the taxation of income from insurance business where the recognition of a permanent establishment or deemed permanent establishment is possible, whereas the intended provision would allow the jurisdiction where premiums are collected, notwithstanding the existence of a permanent establishment, to levy a withholding tax on gross premiums.

3. Comments and concerns

3.1. **Cross-border insurance activity carried out through intermediaries**

The report aims at addressing instances where the current version of the UN Model Convention is not efficient enough to allow taxation on insurance income. As article 7 of the UN Model Convention restricts taxing rights to the recognition of a permanent establishment or deemed permanent establishment, the report seems to consider insurance as a mobile industry that can provide cross-border coverage without any physical presence.

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On that matter, GFIA would like to highlight that insurance:

- is a highly regulated industry and to sell insurance in a country the insurer has to comply with local regulation on insurance and meet local regulatory capital retention to match local risks;
- has to stay close to the customers given the nature of the insurance coverage provided (protection, general insurance, life insurance);
- cannot be assimilated to a passive activity whose income is traditionally subject to withholding tax (eg, dividends, royalties, interests);
- is a specific line of services business requiring an estimate of future costs to determine the premium, because insurers collect premiums first and pay expenses later over the duration of the coverage (general expenses, claims), meaning that gross premiums are not a measure of the insurer's actual profit/loss for a given line of insurance business; and,
- is usually taxed where the risks lie, through indirect taxes on premiums and/or corporate income taxes on the branch operating in the country.

Actually, insurance cannot typically be carried out without any physical presence in the country where the risk lies[1].

3.1. Reinsurance

The report describes reinsurance as a very mobile activity with undertakings mainly located in tax havens and jurisdictions with lenient regulatory requirements, aiming at shifting profits from an insurance company to a reinsurance company.

Reinsurance is insurance for insurers, thus allowing them to lay off their exposure to risks. Reinsurers pool and diversify the risk of primary insurers on a larger scale to mitigate possible losses, thus avoiding the concentration of exposure to a single event or series of events. 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 is therefore regulated under similar rules to those applicable to insurers and reinsurers report to similar supervisory bodies at domestic and international level. In some jurisdictions, reinsurers are required to provide guarantees (cash deposit, asset pledging, letters of credit) before entering a reinsurance arrangement with local insurers.

Reinsurers are exempted from the current provision of paragraph 6 under article 5 of the UN Model Convention creating a deemed permanent establishment, but that is not unique, as many tax systems provide for different tax treatments for specific classes of insurance. A reinsurance company is usually taxed where the respective reinsurance functions are performed to write and pool the risk. Moreover, writing reinsurance entails capital that flows both ways; reinsurers receive premiums including a margin for risks reinsured and insurers receive a significant commission (ranging from 10% to 30%)

[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 has to be licensed in one of the member states to provide coverage in other EU countries. As regards taxation, Directive 2009/138/EC on the taking-up and pursuit of the business of insurance and reinsurance 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".*

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.

3.2. Impact on premiums for insurance coverage in developing countries

The report suggests introducing a paragraph 6 under article 7 that would allow a contracting state to levy a withholding tax on all premiums collected locally.

As mentioned above, the core feature of insurance and reinsurance is an inverted production cycle, meaning that income (premiums) is received before expenses actually 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 usually takes 15 to 30 years. As opposed to what the report sets out, insurers' business frequently results in a net loss. Levying a tax on a gross amount such as insurance would not achieve the goal of taxing the insurer's profits.

Therefore, as the UN Model Convention is usually referred to in double tax treaties agreed with developing countries, if an insurer that is considering operating in any such jurisdiction has to anticipate a withholding tax, then the premiums charged locally may increase. This is a consequence of the fact that the withholding tax may raise the overall tax burden of the insurer.

3.3. Risk for double taxation

Given the variety of taxes and parafiscal charges insurance is subject to, it may be difficult for treaty negotiators to balance taxing rights. Some taxes apply at subnational level and therefore cannot be included in the taxes covered by the treaty for that purpose.

Double taxation occurs when the withholding tax cannot be entirely credited against the tax liability in the residence country which provides double taxation relief through the credit method.

Taxing gross premiums may even lead to taxation in loss situations for an insurer. For some classes of insurance, the premium volume can be very large, whereas the insurer records a very small profit or a loss. Accordingly, taxing insurers and reinsurers on the basis of gross premiums carries the inherent risk of an unfair over-taxation. In some cases, there is even a risk of multiple taxation on the same insurance risk. That is why reinsurance is often exempted from premium taxes.

3.4. Articulation with Pillar Two

It must be ensured that the envisaged withholding tax will qualify as a covered tax under the GloBE rules. Otherwise, the simplification sought by designing the new source country taxation right as a withholding tax instead of a profit-based tax would be achieved with a deterrent adverse-effect that may have an impact on future strategic choices of insurers.

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 on the important discussions that lie ahead with regard to the envisaged proposal.

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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.