GFIA
GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

4 November 2024

GFIA's comments on Article 12 C of the UN Model Convention on cross-border insurance and reinsurance

1. Summary

1.1. After a proposal (E/C.18/2023/CRP.40) to amend Articles 5 and 7 of the UN Model Convention as presented at the 27th session, the UN Committee of Experts on International Cooperation in Tax Matters (the "UN Tax Committee") agreed on the introduction of a new article, Article 12C relating to income from cross-border insurance and reinsurance activities that was first discussed for opinion at the 28th session of the UN Tax Committee.

1.2. For the 29th session of the UN Tax Committee, the Co-Coordinators' Report (E/C.18/2024/CRP.32 hereafter referred to as "the paper") was presented for approval.

1.3. During the session, the Global Federation of Insurance Association (GFIA) shared the views on the paper of its 42 member associations and 2 observer associations, representing the interests of insurers and reinsurers in 70 countries and accounting for 89 % of total insurance premiums worldwide. GFIA representatives provided insight on the specifics of the insurance industry and a few comments on some of the new elements introduced in the paper compared to the version presented at the 28th session, notably regarding beneficial ownership, fronting and reinsurance and also the definition of insurer.

1.4. GFIA acknowledges the extensive work achieved by the Committee on this version of the paper concerning the taxation of income from cross-border insurance and reinsurance, some of which reflects comments made in earlier submissions. In that regard, GFIA would like to highlight the exclusion of insurance contracts with a substantial investment component and the drafting of the location of risk criterion, which is clearly positioned as an alternative with pros and cons for inclusion.

1.5. Article 12C was adopted during the session, with pending amendments to the Commentary. The Committee thus invited written comments to adjust the paper to be presented at the 30th session in March 2025 in New York.

1.6. GFIA would gladly complement previous submissions by expanding on comments made during the session in the note below and provide further insight on issues voiced during the discussions on Article 12C.

1.7. This note provides comments on four areas, namely:
   (a) the interaction with Article xx;
   (b) the definition of "insurer" in para. 3(b) of Art. 12C;
   (c) beneficial ownership as discussed in the Commentary to para. 2 of Art. 12C; and
   (d) taxing by location of risk, which is suggested at para. 54 of the Commentary as an alternative para. 5 of Art. 12C.

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2. Interaction with Article 12 xx

2.1. GFIA is grateful for the exclusion of annuity contracts and contracts with a substantial investment component from the definition of “insurance premiums” in subparagraph 3(a) of Article 12C and for the explanation of the purpose of the exclusion in paragraph 34 of the Commentary.

2.2. For the same reasons, GFIA is keen to ensure that such premiums are not inadvertently brought within the scope of the newly-adopted Article xx as fees for services. The definition of “fees for services” in paragraph (3) of Article xx is broad as the term means “any payment in consideration for any service”. The rationale for excluding these premiums from the scope of Article xx is the same as for excluding them from the scope of Article 12C – that they effectively represent deposits of policyholders’ money.

2.3. It will also be necessary to consider the interaction of Article 12C and Article xx in other cases where a payment which is commercially considered an insurance premium is not within the scope of Article 12C. One example of this, which is discussed in paragraph 39 of the Commentary to Article 12C, is where a country considers that an amount paid to a captive insurer is not in the nature of an insurance premium. If such premiums are to be excluded from the scope of Article 12C, it appears that they should also be excluded from Article xx.

3. Definition of “insurer”

3.1. The definition of “insurance premiums” in subparagraph 3(a) of Article 12C is limited to amounts that are “paid to an insurer”. Subparagraph 3(b) of Article 12C then defines “insurer” as meaning “a person or arrangement, the majority of the income of which consists of premiums and other amounts received in consideration for the issuance of insurance, reinsurance and annuity contracts and investment income related thereto.”

3.2. Paragraph 38 of the Commentary to Article 12C explains that the purpose is to distinguish premiums paid under insurance contracts from amounts paid under other financial instruments that are typically issued by non-insurers. Although the wording of Article 12C contributes greatly to this, GFIA is concerned that, under certain fact patterns, a bona fide insurance enterprise could fall outside the treaty definition. Examples of fact patterns that may cause difficulty include:

3.2.1. in any given year an insurance enterprise may suffer significant losses on investment markets. This could lead to the aggregate amount of premium income and investment losses being negative or otherwise less than “other income” it receives; and

3.2.2. when an insurance enterprise goes into “run off” it ceases to enter into new insurance contracts and its premium income greatly diminishes. In these circumstances, its premium income greatly diminishes and the sum of its premium income plus the investment income on assets directly backing its liabilities may no longer constitute the majority of its income, particularly where the company also earns a fee or other income for non-insurance services provided.

3.3. A contributory factor is a lack of clarity as to whether “investment income related thereto” in subparagraph 3(b) is limited to those assets that directly back an insurer’s liabilities or whether it also includes investment income that arises on regulatory capital and surplus assets. Adding Commentary in paragraph 38 to the effect that it means the latter would therefore be helpful.

3.4. GFIA would also support, in line with comments that were made during the 29th session, adding an alternative leg to the definition of “insurer” that countries may choose to adopt in their bilateral treaties in order to dispel cases of doubt such as those referred to above. This approach would draw upon the

regulated nature of insurance business. By adding it as an "or" test, any business caught by the existing definition would still be in scope and it would reduce the chance of disputes in other cases.

3.5. The alternative text, which could be included in paragraph 38, may allow countries to amend the text of subparagraph 3(b) as follows (shown in underlining):

3.5.1." The term 'insurer' means a person or arrangement,
(i) the majority of the income of which consists of premiums and other amounts received in consideration for the issuance of insurance, reinsurance and annuity contracts and investment income related thereto; or
(ii) which is regulated as an insurance or reinsurance enterprise in a Contracting State."

3.6. If the Commentary is amended as above it will also be necessary to review the final sentence of paragraph 39 concerning captive insurers, as in some circumstances a country may view payments made to a regulated captive insurer as not constituting insurance premiums. As jurisdictions typically have a specific regulatory regime for captive insurers (which differs from that for insurers which take on business from unrelated parties) one option would be to carve those captive regimes out of subparagraph (ii) above, and in this case the final sentence could stay as it is. A different approach would be to retain in the Commentary a statement that a country should not apply a withholding tax to an amount paid to a captive insurer if it deems the payment not to be an "insurance premium" under its domestic tax law, but to delete the reference to the captive not being an "insurer". As noted in Section A above, the potential interaction with Article xx in such situations should also be addressed.

4. Beneficial ownership and fronting arrangements

4.1. Paragraph 19 of the Commentary to Article 12C contains a very brief description of "fronting" and concludes that a fronting company should not be treated as the beneficial owner of the premium it receives. However, the description is oversimplified. It does not reflect the variety of different commercial arrangements that can be entered into, and as a result the conclusion lacks necessary nuance.

4.2. As paper E/C.18/2024/CRP.32 notes (at paragraph 8), fronting arrangements are frequently used in connection with captive insurance. Their other main use is in relation to multinational insurance programmes where an insurer does not have the necessary licence to insure a specific risk with a policyholder in a given jurisdiction. In both cases the essence of the arrangement is that the unlicensed insurer identifies the risk and brings it to the fronting company which is regulated as an insurer in the relevant jurisdiction. The fronting company then enters into an insurance contract with the policyholder, and the unlicensed insurer reinsures the fronting company. As an aside, although in some circumstances a captive insurance arrangement may not (as stated at paragraph 8) serve the purpose of risk shifting and risk distribution, those characteristics certainly are present when a fronting arrangement is used to take on risks from unrelated parties.

4.3. There are also many variables in the way that fronting arrangements can be set up. These variables affect the analysis of whether or not the fronting company has beneficial ownership of premiums that it receives from the policyholder.

4.4. First, it should be noted that a policyholder's legal contract is with the fronting company and not with the locally unlicensed insurer. There is in general no privity of contract[1] between the policyholder and

[1] Privity of contract is a principle which prevents a person who is not a party to a contract from enforcing a term of that contract. This principle applies even where the contract was specifically made to confer a benefit on that person.

the locally unlicensed insurer (which is the reinsurer of the fronting company) so the policyholder does not have a right to make a direct claim against it. There may, however, be some exceptions to this: under some governing laws such a right may be conferred through a "cut-through clause" in the contractual terms; and in some jurisdictions (and in some circumstances) the courts have allowed policyholders to make claims on a reinsurer in the event of the liquidation of a fronting company.

4.5. By the same token, the fronting company's obligation to indemnify the policyholder is not dependent on it receiving funds from the locally unlicensed insurer, which is its reinsurer. In the event of the failure of its reinsurer the fronting company is still under an obligation to pay valid claims. Although this credit risk can be mitigated (for example, by withholding funds received as premiums before they are paid on to the unlicensed reinsurer, or by requiring the reinsurance contract to be collateralised by letters of credit or other assets) it is a commercial factor and one against which a fronting company would generally be required to hold regulatory capital.

4.6. A third variable is whether a fronting company reinsures all the insurance risk with the unlicensed insurer. For example, as described in the UK tax authority's published guidance on fronting and captive insurance[2], in some circumstances a fronting company may retain the highest levels of insurance risk and only reinsure the lower levels to an unlicensed captive insurer. Also, in certain jurisdictions the regulatory regime requires fronting companies to retain a portion of the risk that they underwrite. Paragraph 19 of the Commentary does not deal with such situations as it refers to a fronting arrangement as one in which the fronting company reinsures the entire risk to the locally unlicensed insurer.

4.7. There are other variables, such as the degree to which the fronting company takes on the functions of claims handling and the degree of operational or other risk to which it is exposed. One factor that is worth highlighting is the question of whether or not the fronting company is able to benefit from the investment return on premium it receives before it pays amounts on to the unlicensed insurer.

4.8. The Commentary refers to the 1986 OECD Report on Conduit Companies.[3] Although that report focuses on companies holding assets that produce interest, dividends and royalties, which are less complex than insurance companies, the considerations around beneficial ownership should be the same. Considering the range of different types of fronting arrangements, the liabilities that a fronting insurer may take on and the range of functions that it may perform, it is therefore not safe to say that the same conclusion will be reached in every case and for all arrangements. Under some fact patterns, a fronting company underwrites genuine insurance and is liable to pay claims regardless of whether it receives payment form the reinsurer, and therefore does not meet the description[4] of having "very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties…"

4.9. GFIA therefore requests that paragraph 19 of the Commentary to Article 12C should be expanded to reflect some of the diversity of fronting arrangements that exist, and that the example in paragraph 20 should include some of the elements that support the conclusion that, in that case, the fronting company does not have beneficial ownership of the premiums it receives. GFIA has suggested some wording in the Annex for the Subcommittee's consideration.

[2] HMRC's General Insurance Manual GIM11030
[3] https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2014-full-version/r-6-double-taxation-conventions-and-the-use-of-conduit-companies_9789264239081-99-en#page1
[4] para.14(b) of the OECD Report reflected in para.17 of the Commentary on Article 12C

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5. Taxing by location of risk

5.1. The Commentary on Article 12C discusses (at paragraphs 52 to 57) the alternative provision under which the country in which a risk is situated could tax premiums insuring that risk. This alternative, which would be subparagraph 5(b) of Article 12C, can only apply where the primary rule of taxing by source of payment does not apply under the same treaty. GFIA would like to take this opportunity to address some comments that were made on this issue during the 29th Session.

5.2. As has previously been made clear, GFIA thinks the alternative provision is complex, would be difficult to apply in practice, and would give rise to instances of double or multiple taxation. The double taxation could arise in one of three ways: where the source country of payment and the location of risk assert a taxing right over the same premium; where different countries have different rules defining the location of risk; or where the same risk is the subject of multiple layers of insurance and reinsurance. These concerns are reflected in paragraphs 53 and 57 of the Commentary and GFIA strongly supports their inclusion.

5.3. During the discussion on 16 October, one issue that was raised was a potential difficulty with taxing based on the source of payment in situations where the head office of a multinational enterprise makes a single premium payment covering risks that are owned by various group entities and located in different countries. A parent company may, for example, take out a policy in the name of itself and its subsidiary companies to insure risks that are located across a number of territories. The view was expressed that in such a situation the countries in which the subsidiaries are located (and in which risks are also situated) may not be able to tax the premium relating to their territory unless they also have a right to tax by the location of risk. This issue is noted in paragraph 52 of the Commentary.

5.4. Although this view has some force, GFIA believes that the practical effects are less extensive than might first appear. In most cases GFIA would expect a parent company that takes out such a policy to recharge the cost of insurance that relates to its subsidiaries to those subsidiaries. This places the economic cost with the entity that has the insurable interest and thereby also increases the likelihood that it is tax deductible. In such a situation, the country in which the subsidiary is located may be able to apply a gross withholding tax to the payment of the insurance cost by the subsidiary in question, particularly if said facts indicate that the beneficial owner of that payment is the insurance company that has issued the policy, rather than the parent company acting in an intermediary capacity. This analysis should hold good irrespective of whether the insurance premium is recharged separately or bundled together with other charges made by the parent to the subsidiary.

5.5. There was also some discussion on the difficulty of determining the location of certain types of insurance risk. Domestic law definitions can vary from country to country, and although it is relatively straightforward to determine where some types of risk are located, others are notoriously difficult. GFIA has previously given some examples in each category. Reinsurance poses a particular problem as it has to be determined whether the risk is located where the reinsured party is located or whether there needs to be a look through to the location of the risks that are insured under the primary contracts of insurance (and in the latter case how you do this in practice with excess of loss reinsurance contracts and/or multiple layers of reinsurance). These issues, together with the administrative difficulties and potential for double taxation that result from them, are reflected in paragraphs 53 and 57 of the Commentary.

5.6. GFIA sympathises with those who would like some further guidance to assist both domestic lawmakers and treaty negotiators in defining the location of insurance risk. However, given the breadth and complexity of the issues, GFIA suspects this may be too large a subject to treat in any detail in the Commentary to Article 12C. Moreover, there is no guarantee that all countries would agree on the definitions. GFIA's expectation is therefore that those countries wishing to include subparagraph 5(b) of Article 12C in a bilateral treaty would start from their existing domestic definitions for insurance

regulatory or indirect tax purposes and then discuss these with their treaty partners as recommended in paragraph 37 of the Commentary. Any such discussions should in particular consider whether to exclude reinsurance from the scope of subparagraph 5(b), and if not, how the location of reinsured risk should be determined.

ANNEX – Beneficial ownership and fronting (suggested changes in revision marks)

Commentary on Article 12C paragraphs 19 - 20 (suggested changes shown in revision marks**)**

19. Whether entering into a reinsurance contract affects the insurer's status as a beneficial owner of the insurance premiums it receives depends on the terms of that contract. Any examination should therefore entail considering the terms of the contract or arrangement in question.

19A. ~~In the case of~~ Under a "fronting" arrangement ~~company~~, an insurance company that is not licensed to take on certain risks in a jurisdiction identifies and prices a risk that it wishes to take on there and enters into an arrangement with a company that has a licence. The locally licensed company (called the "fronting" company) then enters into an insurance contract with the policyholder ~~instead of a company that is not so licensed,~~ and immediately reinsures the underwriting risk with the locally unlicensed company. The fronting company receives a commission in return for participating in the transaction The policyholder's contract is with the fronting company, which may have credit risk against the potential default of the unlicensed company that is its reinsurer. Fronting arrangements are not, however, uniform and depending on their terms the unlicensed company may take on other functions such as the handling of claims, although the licensed company will be responsible for complying with regulatory rules. In some cases, a fronting company can benefit from the investment return on premiums which it receives before it pays it on as reinsurance premium while in others the investment return accrues to the benefit of the unlicensed insurer. In ~~this~~ some cases, ~~the~~ a fronting company should not be treated as the beneficial owner of the premiums it receives.

20. For example, assume that a group of doctors located in State S, bands together to establish a captive insurance company, Captive, in State R to insure the doctors against medical malpractice risk. Captive is not licensed to provide insurance in State S. Accordingly, Insurer T, a resident of Country T that is licensed to provide malpractice insurance in State S, agrees to "front" the insurance coverage by issuing insurance policies to the doctors on the condition that Captive will immediately reinsure the entire risks and pay a commission to Insurer T for its participation in the transaction. Captive identifies the business, prices the insurance and handles claims on behalf of Insurer T and fully collateralises the reinsurance up to the limit of Insurer T's maximum potential liabilities to policyholders. Insurer T receives no benefit from the arrangement other than the commission. There is a treaty between State T and State S that includes Article 12C. However, in this case, Insurer T should not be treated as the beneficial owner of the premiums received from the doctors.

GFIA thanks the Committee for the opportunity to expand in written comments on topics discussed during the 29th session and looks forward to engaging further with the Committee in the discussions that lie ahead in preparation of the 30th session, should any query arise.

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About GFIA

The Global Federation of Insurance Associations (GFIA), established in October 2012, represents through its 42 member associations and 1 observer associations the interests of insurers and reinsurers in 68 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.