

GFIA's response to the OECD Discussion Draft on Additional Guidance on the Attribution of Profits to Permanent Establishments

GFIA is pleased to respond to the OECD's discussion draft on "Additional Guidance on the Attribution of Profits to Permanent Establishments" (the "discussion draft"). In general, GFIA supports the objectives of the OECD BEPS Action Plan to address weaknesses in the international tax environment. Accordingly, we support the OECD's broad objectives 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.

The preamble to the discussion draft refers to paragraphs 19-20 of the final Report on Action 7 of the BEPS Action Plan (Preventing the Artificial Avoidance of Permanent Establishment Status) which concludes that the changes discussed in the final Report do not require substantive modifications to the existing rules and guidance concerning the attribution of profits to a PE under Article 7 but that there is a need for additional guidance on how the rules of Article 7 would apply to PEs, in particular for PEs outside the financial sector (emphasis added). While the focus of the Additional Guidance is on PEs outside the financial sector, GFIA is concerned about the potential impact of certain proposals in the discussion draft on the insurance sector.

As outlined in GFIA's previous submission to the OECD (see Appendix), GFIA's main concern with the proposed PE rules is that, for some insurance business models, PEs would be recognised for tax but not for regulatory purposes with no or minimal additional profit being attributed to them. This would result in an excessive compliance burden for both insurers and tax authorities.

The discussion draft recognizes (see paragraph 104) that there could be situations where the profits attributed to a PE are nil but does not propose a solution to avoid the resulting disproportionate compliance burden for insurers. GFIA is disappointed with this situation and disagrees with the suggestion that these PEs may nevertheless be justified by the potential existence of "other tax liabilities". At least in an insurance context, this would not be the case.

GFIA reiterates its strong view that only the presence of Key Entrepreneurial Risk-Taking (KERT) functions in a jurisdiction should create a PE and the attribution of profits for tax purposes. The 2010 OECD Report on the

Attribution of Profits to Permanent Establishments Part IV (Insurance) (“Part IV”) recognizes that the main KERT function of insurers is the assumption and management of insurance risk/business (i.e. underwriting).

The broader definition of PE in the discussion draft could potentially create PEs for insurers with no or minimal profit attributed to them in the following situations:

- The insurer sells and markets insurance products. Part IV recognises that such activities are unlikely to be KERT.
- A related service company performs non-KERT functions (such as back-office processing of applications, administrative support, claims handling and investment management).
- An unrelated third party agent performs non-KERT functions and acts exclusively for an insurer.
- An agent acts exclusively (or almost exclusively) for the insurer under a Delegated Underwriting Authority (DUA) and does not perform any KERT functions (which would be the case if the authority under the DUA is strictly limited).
- A connected agent performs regulated non-KERT activities (eg. sales and distribution) in the same jurisdiction as the customer and is rewarded directly by the customer on an arm’s length basis (for example, a broker distributes insurance and is compensated through a fee charged to the customer, in addition to any fees from the insurer).

GFIA’s view is that insurance distribution networks should not generally give rise to PEs for tax purposes since:

- distribution activities are compensated by commissions and
- the commissions are subject to tax in the distribution location.

There is no reason why further income should be attributed to a dependent agent PE if the agent’s enterprise is remunerated on an arm's length basis, considering the risks assumed by the dependent agent enterprise.

Similarly, when a bank distributes insurance, the insurer should be viewed as independent from the bank since the bank:

- distributes products without the authority to negotiate insurance contracts and
- may also distribute similar products from other competing insurers.

GFIA believes the approach in example 1 of the discussion draft would be very difficult to apply in an insurance context, since there is nothing analogous to cost of goods sold (which in example 1 is equal to sales income to the head office in Country A to ensure there is no profit attributable to the PE in Country B). If the methodology of example 1 was for some reason applied to an agent undertaking non-KERT functions in Country B for an insurer, all the premium from writing the business in Country B would be inappropriately attributed to the PE in Country B, even though only non-KERT functions were performed in Country B. That would clearly conflict with Part IV.

GFIA strongly recommends that the OECD avoid the creation of PEs in the circumstances discussed above, particularly since the OECD recognizes that no profit will be attributed to these PEs. This would avoid an unnecessary compliance burden on insurers. One way to address this problem would be to add some words to the commentary on Article 5 under paragraph 39 to note that the facts and circumstances of the business value chain should be considered as part of the determination of whether or not a PE is created. We strongly

recommend adding a reference to Part IV since it provides comprehensive guidance defining and discussing the risks, risk management and allocation of risk in the context of the insurance business.

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About GFIA

Through its 41 member associations, the Global Federation of Insurance Associations (GFIA) represents the interests of insurers and reinsurers in 60 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.

APPENDIX

The comments in this appendix were submitted to the OECD on 12 June 2015

GFIA Comments on OECD Revised Discussion Draft on BEPS Action 7 (Prevent the Artificial Avoidance of PE Status)

Introduction

The Global Federation of Insurance Associations (GFIA) through its 39 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 revised discussion draft on "BEPS Action 7: Preventing the Artificial Avoidance of PE Status" (the "discussion draft"). In general, the GFIA supports 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.

General comments

We welcome and fully support the conclusion of Working Party 1 that no specific rule for insurance operations should be introduced.

We welcome the decision to provide additional guidance on the issue of attribution of profits to PEs. The discussion draft notes that follow-up work on attribution of profits issues related to Action 7 will be carried on after September 2015 with a view to providing the necessary guidance before the end of 2016, which is the deadline for the negotiation of the multilateral instrument that will implement the results of the work on Action 7. ***We recommend that such guidance be released in draft form for public comment, with sufficient time (at least 45 days) for public review and consultation. The need for adequate consultation time is critical given the complexity of this subject.***

The revised commentary on interpreting Articles 5(5) and 5(6) to deal with commissionaire arrangements appears to be written in the context of businesses that sell goods. In addition, the commentary does not take into account the relative importance of the functions performed by the business in question – in particular, no recognition is given to where the KERT function (i.e. what drives the profit) is performed. If neither the nature of the business nor the importance of the function are taken into account, the outcome will be numerous PEs being created with nil or little additional profit being attributed. This would result in a disproportionate burden being placed on business. The particular concerns in the insurance context are with respect to:

- sales and marketing of insurance
- non-KERT functions performed by an in-house service company, such as back office processing of applications, claims handling, investment management, and administrative support.

With respect to the sales and marketing of insurance, 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 93¹ and 94). Accordingly, the KERT function rests with the entity which accepts and manages the risk/business (ie. the insurer and not the agent).

Part IV provides comprehensive guidance defining and discussing risks, risk management and the allocation of risk in the context of insurance businesses. Accordingly, given the extensive work that has gone into developing Part IV and the limited time remaining to complete the BEPS action plan, ***we recommend referencing the relevant existing guidance in Part IV for insurers in the commentary on Article 5(5) and 5(6)*** (for example in paragraph 39). ***We also suggest that the commentary be extended to ensure that, when consideration is given to whether a PE exists, the relative importance of the functions performed by the business in question should be taken into account.***

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¹ 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.