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Dear Jeffrey,

**DISCUSSION DRAFT ON THE ATTRIBUTION OF PROFITS
TO A PERMANENT ESTABLISHMENT: PART IV (INSURANCE)**

Lloyd's is pleased to have the opportunity to comment on the OECD's draft Part IV. The OECD has clearly invested a lot of effort into the draft, and we compliment you on its breadth and quality. It provides a useful basis for further discussion, and we hope that the final version of Part IV will be able to be as accurate and helpful as possible. We will, of course, be happy to support you in the process of finalising it.

Lloyd's has contributed to and supports the submissions made by the CEA and by BIAC, and in the interests of brevity we do not propose to repeat here the points that are made in those submissions. However, we would like to add a few comments in two areas.

First, we would like to stress that one objective of the exercise must be to improve the clarity of the rules for taxing permanent establishments, and hence the certainty of treatment. We fear, however, that the current draft falls short of this objective. This is particularly the case given the scope for different tax authorities to take different views with regard to the same facts and circumstances, and we have a real concern that one consequence of the present draft would be to cause greater uncertainty and administrative costs with no guarantee of a fairer result for any party.

Second, we have some comments on agency PEs. These are subject to the general caveat that, as the CEA and BIAC point out, the place for general discussion of dependent agency PEs is in Part I. Where applicable, our comments should therefore be taken as commenting on Part I as well as on Part IV.

Although Article 5 is of great importance, it is excluded from the scope of the current OECD exercise. The discussion draft should therefore focus on how profits may be attributed to an agency PE that exists under the applicable treaty, without any comment on the likelihood of that being the case. We think the discussion draft is, however, right to note at paragraph 63 that in a number of instances contracting OECD countries have entered into treaties which allow a lower standard for an agency PE of an insurer than the OECD model provision does. This can, in some cases, extend the ability to create an agency PE to independent agents.

Some practical points need to be considered. An agent that in theory gives rise to an agency PE may be either related or unrelated to the principal; and, as noted above, in some cases an agent that is independent of an insurer may nonetheless give rise to an agency PE under a particular treaty. Moreover, as the discussion draft notes (again at paragraph 63), an agency PE may under some treaties be created simply because premiums are collected through an agent. In this regard you may recall that, at the OECD public consultation on 12 April 2002, the CEA suggested that it can be useful to draw a distinction between, on the one hand, a PE of an insurer that is an “insurance PE” in the sense that it carries risk, and, on the other, a PE of an insurer that is a “non-insurance PE” in the sense that it performs other functions. It would seem clear that an agency PE that merely collects premiums should fall into the category of a non-insurance PE, and that any profit attribution ought to be determined by reference to the collection activities it performs rather than the underwriting result (subject to adjustment for the reward that is paid to the agency enterprise itself). Although it is expressed differently, we believe that this is the effect of the final sentence of paragraph 120 of the draft.

Paragraphs 118 and 119 refer to the need to analyse the activities that the agency PE carries out on behalf of the insurer. We think it is important to emphasise that only the activities carried out on the insurer’s behalf should enter into this analysis. We suggest it would be useful to note here that an insurance broker typically acts on behalf on the policy holder rather than for the insurer, even though it is remunerated by commission. In such circumstances the activities of the broker will not create a PE of the insurer under the model OECD convention, although they may create a PE under treaties that deviate from that standard. In circumstances where the broker has authority to bind the insurer to a risk in the host territory, however, the carrying out of that function in the host territory can create a PE of the insurer under the model OECD convention provided the agent is dependent on the insurer.

With regard to the analysis of activities, one point that needs to be borne in mind is that carrying out a full facts and circumstances test may be far from straightforward. The practical difficulties will be greater if the agent is independent of or unrelated to the principal.

Paragraph 121 points to the need to deduct the arm’s length reward that is paid to the agency enterprise in arriving at the measure of the profit, if any, of the agency PE. We agree with this approach and that, in the words of the draft “[i]ssues arise as to whether there would remain any profits to be attributed to the dependent agent PE after an arm’s length reward has been given to the dependent agent enterprise”. In very many cases, and especially where an agency PE of an insurer is considered a “non-insurance PE”, we believe that a full facts and circumstances analysis would lead to the conclusion that no profit is to be attributed to the agency PE after this arm’s length reward has been deducted.

We hope that these thoughts and comments are useful. We will be happy to clarify anything that is not clear, and we look forward to continuing to contribute to the further development and finalisation of Part IV.

Yours sincerely,

David Clissitt
Head of Tax & Treasury