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Dear Mr Owens

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

PricewaterhouseCoopers welcomes the opportunity to comment on the issues raised by the OECD Part IV discussion draft. Our representations have been drawn up by a working party within PwC's global insurance network.

We would very much encourage consultation with the insurance industry and commentators at the earliest possible date following the closing date for receiving comments. We would like to play a part in the consultations as we work with a large number of international insurance companies.

Our comments focus primarily on the principles as applied to insurance companies.

**Main Point**

Our main comments relate to the need for further clarity on the differentiation between the acceptance and management of insured risks, and the acceptance and management of non-insured risks, such as marketing risk and market (investment) risk. Our general view is that the allocation of reserves and surplus which are attributable to insured risks should, in the first instance, follow the KERTs responsible for the acceptance and management of insured risk. The acceptance and management of non-insured risks, whilst quite possibly highly valuable, should be remunerated based on arm's length principles, taking into account any specific regulatory capital requirements of those activities/locations.

**Purpose of the Report**

We fully support the OECD's purpose to establish and develop a consensus approach to the interpretation and application of Article 7 of the OECD model tax treaty. The stated objectives of setting out principles and guidance on practice, as well as the testing of the approach within specific areas of the financial services sector, in order to refine and clarify the approach, before finalisation of the principles of Part I, are to be commended.

In spite of the OECD's commendable objectives, there is a danger that the purpose and message of the report may be clouded by the focus of the content on an anti-avoidance agenda. This is

particularly prevalent in Section C of Part IV, but is by no means limited to that section. Our view is that the report is much more likely to be positively embraced by both the insurance industry and tax authorities if it offers clear, balanced and impartial guidance. We would strongly recommend that the content of the paper be balanced in its tone and content to ensure clarity of purpose and to encourage adoption by both tax authorities and taxpayers.

### **Part C – Application of the Guidelines to Insurance Companies operating through Subsidiaries**

This section appears predominantly to raise anti-avoidance concerns in relation to:

- The threshold for recognition of intra-group insurance transactions; and
- The use of CUPs to price intra-group insurance transactions

A number of insurance companies have questioned with us whether it is appropriate to include this section at all since it is not concerned with the attribution of profits to permanent establishments, particularly in view of the fact that there are other projects ongoing within the OECD which seek to address both of these issues.

If the OECD, nevertheless, wishes to include reference to the potential interaction between the development of an authorised approach to attribution of profits to permanent establishments with the approach to transfer pricing between companies, we suggest that this is simply done by reference to the ongoing work at the OECD in relation to this important area.

### **Part D – Applying the Authorised OECD Approach to Insurance Companies operating through PEs**

We are in full agreement with the observations of paragraph 75, which focuses on the identification of the Key Entrepreneurial Risk Takers (KERTs) as the key drivers of profitability within the business. We also welcome the statement in paragraph 76 that KERT functions and their relative importance is likely to vary according to the particular facts and circumstances.

However, the remainder of Part D requires clarification to be able to differentiate adequately between:

1. KERT functions in relation to insured risks – ie pricing, acceptance and management of insured risks, (ie. the underwriting and risk management function); and
2. Other potential KERT functions, eg marketing, IP development, asset management

We suggest that, whilst insurance marketing and asset management may, in themselves, attract a significant proportion of the overall profit in certain cases, and may require the provision of regulatory capital, the risks associated with a failed marketing drive and the risks associated with undertaking asset management are substantially different to the underwriting risks which require the provision of reserves and surplus. It would therefore be inappropriate to propose a default position whereby KERTs associated with risks other than insured risks are allocated some or all of the reserves and surplus attributable to insured risks, along with the associated investment income.

Paragraphs 94/5 further cloud the issue by suggesting that, where marketing is considered to be a high value activity, retained profits associated with high profitability in the marketing branch would be held as “free capital” and would therefore attract investment income on this investment. In our view, any retained profits within an insurance company which are over and above its capital requirements in respect of its insured risk would be equally likely to be paid out as a dividend rather than held as unnecessary surplus. To suggest otherwise confuses the difference between the year by year allocation of profits and the efficient use of capital going forward.

We therefore suggest either of the following:

1. A clear differentiation between “insurance” KERTs who manage the risks identified in paragraph 76 and would therefore be identified as the “economic owner/s” of the insurance policy, attracting reserves, surplus and associated underwriting and investment income, and “non-insurance” KERTs, who take on and manage other risks, such as marketing risk, intellectual property development, etc, who would not attract reserves, surplus and investment income (except in the case that they have specific regulatory capital requirements), though they may attract a significant profit attribution; or
2. A clear proposal that, in an insurance context, KERTs are specifically defined by reference to the acceptance and management of insured risks. All other activities, regardless of how highly valued, would not be defined as KERTs.

Paragraph 208 helpfully sets out the assumption that the part of the enterprise that is determined to have performed the underwriting function is to be treated in the first instance as the economic owner of the insurance policy and so is entitled to the associated underwriting and investment income. It would help to clarify the paper if this statement was made earlier in the paper, immediately after paragraph 76. We also suggest that, in paragraph 91, the second bullet point should refer to “insured” risks. Paragraph 101, however, suggests that the underwriting function may not, in certain circumstances, constitute a KERT function. Clearly, the identification of KERT functions will depend on the individual business economic facts and circumstances in each case. However, the implication that some form of “marketing” risk, not defined in Section B, overrides the basic principle noted in paragraph 208 is likely to lead to significant uncertainty.

Naturally, any clarification of the definition and scope of KERT functions should be consistent with that set out in Part I of the report, which we understand is currently being redrafted.

#### **Remuneration for other activities**

We agree with the comments in paragraphs 197 to 206, that there should be no issue, in principle, to prevent the application of the OECD transfer pricing guidelines to the pricing of dealings between the participants in the business. In particular, there are a number of potential CUPs which are available in relation to reinsurance, asset management and marketing activities. Where CUPs are not available, information is often available to use other methods, such as TNMM.

#### **Implementation**

As stated in our response to papers II and III, the variety of approaches, for example, for the attribution of capital under Parts II and III, significantly increases the risk that different tax authorities will hold different views on, or will apply different interpretations to, this material. We note that the increased use of the mutual agreement procedures to resolve such differences in individual cases may substantially increase the burden on tax authorities and the resources they require. Consideration might also be given to a mechanism, such as arbitration, to assist in reaching mutually acceptable solutions in the more difficult cases.

We recommend the practicability of the authorised approach is considered further and note that the “testing” has so far been at the theoretical level. If the proposed approach is finally adopted, we recommend that the timetable for implementing the final proposals allows a reasonable period for companies to introduce the systems, prepare the functional analyses and identify and implement appropriate transfer pricing methodologies and pricing.



Yours sincerely

on behalf of the PricewaterhouseCoopers Insurance Tax Network

Lisa Casley  
Director