CATLIN GROUP LIMITED

Mr Jeffrey Owens
Director, Centre for Policy and Administration
Organisation for Economic Cooperation and Development
2 Rue Andre Pascal
75775 Paris
France

Cumberland House, 6th Floor,
1 Victoria Street, Hamilton,
Bermuda HM 11

P.O. Box HM 1287
Hamilton HMFX
Bermuda

Telephone (441) 296-0060
Fax (441) 296-6016
www.catlin.com

11 November 2005

Dear Mr Owens

Re: OECD discussion draft of the report on attribution of profits to a permanent establishment – Part IV (Insurance)

The Catlin Group is a publicly listed, property/casualty insurer and reinsurer writing more than 30 classes of business worldwide and we wish to take the opportunity to respond to the discussion draft on attribution of profits to a permanent establishment (PE). We are aware that the deadline for responding to the discussion draft has now passed but nevertheless we hope that you will be willing to take cognisance of our views in this matter which we have to stress do not address any issues of the life industry.

We must first note that we consider that the development of a common interpretation and consistent application of Article 7 of the Model Tax Convention across OECD member countries is a very worthwhile aim though we would add that we believe that the contrasting civil and common law systems may lead to very different interpretations of what constitutes a permanent establishment.

We also accept your contention that the Working Hypothesis has gained widespread acceptance and it, coupled with the concept of the key entrepreneurial risk taking function (KERT), certainly seems to us to be a sensible basis on which to approach the allocation of PE profits.

Key responses to the discussion draft

The key Catlin Group responses to the discussion draft are:

1. in our view the discussion draft definition of insurance business is incorrect; in general it is usually the case that the underwriting function will be the KERT and this follows logically from an accurate definition.

2. in a fact and circumstances analysis the separate enterprise hypothesis must be applied comprehensively.

3. it is not appropriate to hypothesise notional transactions; the Working Hypothesis in our view only facilitates the application of OECD transfer pricing principles to a PE.

4. in general the regulatory position should be treated as a safe harbour for the taxpayer.

Discussion Draft framework

Turning now to the detail of the discussion draft we address first of all what appear to us to be the two key definitions which, in their different industry guises, underpin Papers I to IV. They are:

- from Paper IV, Section B1 paragraph 5 – "Insurance business is the business of accepting and managing risks of losses arising from the realisation of events outside the control of the insured."

and

- from Revised Paper I, Section C-2 paragraph 77 – "key entrepreneurial risk taking functions – those which require active decision making with regard to the most important profit generators of the business…."

The definition of a KERT has been altered in Revised Part II at Section B-1 iii) paragraph 10 to become "key entrepreneurial risk-taking functions are those which require active decision making with regard to the taking on and day-to-day management of individual risks and portfolios of risks" and this definition has been imported into Part IV at Section D paragraph 75.

Insurance business

We do not accept the discussion draft's definition of insurance business. Although there is not in UK law a statutory definition, the concept of a contract of insurance was nevertheless defined by Channell J in *Prudential Insurance Company v IRC* (1904) 2 KB 658. who said that - "A contract of insurance, then, must be a contract for the payment of a sum of money, or for some corresponding benefit such as the rebuilding of a house or the repairing of a ship, to become due on the happening of an event, which event must have ... some degree of uncertainty about it and must be of a character more or less adverse to the interest of the person effecting the insurance."

It follows from this definition that insurance business is the business of accepting risks of losses arising from the realisation of events outside the control of the insured, but it does not follow that insurance business includes managing the risk of such losses. We believe that this concept is misleading and leads to erroneous conclusions as to the nature of KERTS in the insurance industry.

It is, however, correct that the insurance business looks to manage the exposures which it faces in respect of potential losses, and these functions and their costs need to be taken into account in determining the profits attributable to a PE. We return to this point later in this response.

KERTS

As we have already indicated, we do believe that the KERT concept is a perfectly acceptable starting point in establishing the attribution of profits to a PE but we do also take the view that it needs tighter definition within the framework of the insurance industry.

In the absence of any pre-existing formal tax definition the starting point must be the dictionary definition; the Oxford English Dictionary defines an entrepreneur as "a person who undertakes an enterprise or business, with the chance of a profit or a loss".

Taking the correct definition of insurance business to be "the business of accepting risks of losses arising from the realisation of events outside the control of the insured" it is evident that in most cases the KERT must be that function which assesses, prices and agrees or otherwise to take on that risk; **that clearly will be the underwriting function and it is here that the true insurance industry KERT is almost inevitably to be found**.

Basis for attribution of profits

You summarise the in principle steps in establishing the attribution of profits in paragraph 91 and, subject to the substantive issues raised above on the Working Hypothesis and the definition of an insurance industry KERT, we agree that they can be summarised to be:

- the attribution of functions, assets and risks between it and the rest of the enterprise….;
- the attribution of surplus based on the attribution of risks and the subsequent attribution of the income from the assets arising from the investment of the surplus;
- the pricing on an arm's length basis of dealings [between it and the rest of the enterprise] that can be appropriately recognised in accordance with paragraph 103;
- the recognition of transactions between the enterprise and associated enterprises and independent third parties that are attributed to the PE;
- the determination of comparability between dealings and uncontrolled transactions etc – we are in fact rather unclear as to what this bullet point from paragraph 91 might add; clearly all dealings and transactions should be on an arm's length basis but there is no harm in restating it.

Some detailed issues arising from the discussion draft

In general we consider that Section B is a fair summary of the basics of the insurance industry and you rightly make clear that a specific facts and circumstances review will always be a pre-requisite for an exercise in attribution of profits.

We are a little unclear as to the purpose of Section C; we have understood the discussion draft to be an exercise in establishing a basis of attribution of profits to a PE and this section does not fit. We do not dispute that some tax jurisdictions, though not all, – see our earlier comment on civil and common law disparities – may take the view that a PE can arise for an insurer through the operations of a subsidiary. This is surely a familiar concept to all and the circumstances of the origination of a PE do not seem to be relevant. If you consider that it is valuable or necessary to include this section we would ask that paragraph 67 be removed or at the very least amended so that it is less inflammatory.

Turning now to Section D we have rather more comments and therefore address these in bullet point format:

- paragraph 75 - we agree that it is necessary to determine in accordance with Article 7 (2) of the OECD Model Tax Convention "the profits which [the PE] might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions".
- paragraph 76 – we do not accept in general terms that an insurance business will have a KERT other than the underwriting function; naturally that function will, depending upon the sophistication or philosophy of the insurer, draw in expertise from other sectors of the enterprise.
- paragraphs 86 and 125 – we do not consider it appropriate to assume that all parts of an insurance enterprise have the same creditworthiness and in fact believe that it is a flawed application of the separate enterprise hypothesis.
- paragraph 87 – the use of the words "increases the scope for tax motivated transfers etc" is inflammatory and does not illuminate the issue of pricing of dealings in any way.

- paragraph 94 – states that for travel insurance "one of the key entrepreneurial risk taking functions will be the marketing function" and the "lion's share of the premium must therefore be attributed [to it]". We do not accept this proposition – clearly the value of the product is in the underwriting which underpins its development and the remuneration of the marketing function should be at best on a commission basis. To take a mundane parallel we think it highly unlikely that, say a car manufacturer, would accept the proposition that the car salesman should earn the lion's share of profit – the value for them, and the profit, is in the development and, to an extent, the manufacturing, and this is directly analogous to the development of the commoditised product in the insurance industry.

- paragraph 106 – the asset management function is certainly one of the keys to ensuring that an insurance business is profitable, as are for example effective reinsurance programmes, effective claims handling and expense control, but it is not generally a KERT in the insurance industry.

- paragraphs 126–175 – the issue of attribution of surplus and investment income are perhaps the most difficult. We take the view that tax administration should be as simple and burden free for businesses as is possible; it must be remembered that the vast majority of transactions have no tax thought given to them at all, let alone are tax motivated, and this is the spirit in which this issue should be approached. We consider it appropriate that the start point for tax should be the regulatory position – if the regulator considers that policy holders are adequately protected it seems right to us that the tax authorities should take this as their own starting point; in fact we would argue that a satisfactory regulatory position should generally be a safe harbour for tax. We do nevertheless acknowledge that a facts and circumstances review could lead a tax authority to the view that the regulatory position was not appropriate for tax.

- paragraphs 183–196 – we accept that sometimes a PE will enter into either external or internal reinsurance arrangements. However, where no such contract has been made we do not consider it necessary to hypothesise such a notional reinsurance. Nonetheless, it is entirely appropriate to recognise that where risk management is carried out centrally then its value and cost should be recognised in the attribution of profits to the PE.

We express no opinion on Sections E and F.

As we said at the start of this response, we are aware that the time limit for responses has now passed but we hope nevertheless that you will find our comments of value. If you wish to clarify any of the points contained please contact the Group's Head of Tax, Matt Goodwin, directly.

Yours sincerely,

Matt Goodwin
Head of Tax

Direct line: 00 44 (0)20 7648 8255
E-mail: Matt.Goodwin@catlin.