

Canadian Life
and Health Insurance
Association Inc.

Association canadienne
des compagnies d'assurances
de personnes inc.

November 8, 2005

Mr. Jeffrey Owens
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration
OECD
2, rue André Pascal
75775 Paris
FRANCE

Dear Mr. Owens,

OECD Discussion Draft of the Report on the Attribution of Profits to a Permanent Establishment - Part IV (Insurance)

The Canadian Life and Health Insurance Association is pleased to have been provided the opportunity to respond to the request for comments on the Discussion Draft of the Report on the Attribution of Profits to a Permanent Establishment - Part IV (Insurance) ("the Part IV Report").

Established in 1894, the Canadian Life and Health Insurance Association ("CLHIA") is a voluntary non-profit association with member companies accounting for about 99 per cent of Canada's life and health insurance business. The industry protects almost 24 million policyholders in Canada, paying out \$48 billion a year in benefits.

We acknowledge the substantial efforts of the OECD in dealing with the complex issues involved in allocating profits to a permanent establishment (PE) of an insurer. The CLHIA is generally in agreement with the contents of the Part IV Report. However, there are a number of issues that we believe should be addressed before the Part IV Report is finalized.

We are concerned that the OECD does not appear to have set aside sufficient time to deal with the important issue of attributing profits to a permanent establishment ("PE") of an insurer. We believe that there is a real need for ongoing input from the insurance industry as the paper is revised. We are also concerned with respect to the limited time available to the industry before implementation of the recommendations of the Part IV Report.

1 Queen St. East
Suite 1700
Toronto, Ontario
M5C 2X9

Tel: (416) 777-2221
Fax: (416) 777-1895
www.clhia.ca

1, rue Queen est
Bureau 1700
Toronto, (Ontario)
M5C 2X9

Tél: (416) 777-2221
Fax: (416) 777-1895
www.accap.ca

Toronto • Montreal • Ottawa



SPECIFIC ISSUES

B. Factual and functional analysis of an insurance business

- The Part IV Report should acknowledge that the insurance industry is a highly regulated industry. Host country regulation will typically determine how insurers can be organized, the licensing requirements and how much capital must be maintained in the jurisdiction. These regulations would generally specify whether an established PE is required to be maintained in that jurisdiction in order to carry out specific types of business. There are often different regulatory requirements for different types of insurance businesses.
- The Part IV Report should also acknowledge that insurers are required to have effective internal controls and corporate governance policies in place. These controls are subject to audit and detailed review, particularly in the current Sarbanes-Oxley environment.
- A factual and functional analysis may be necessary to determine the most appropriate method of attributing profits, but this must be carried out in a manner that reflects the reality of the particular insurance company's operations. We do not believe a single cookie-cutter approach can lead to reasonable results for all insurers due to the wide variety of insurance operations and structures in existence. The recommendations must provide sufficient leeway for a reasonable interpretation for each company's unique situation.
- As set out in the Part IV Report, the establishment of broad underwriting practices for the enterprise is not considered part of the underwriting function, but is identified as part of the risk management process. However, inserting the description of this activity within the section on "Underwriting Insured Risk" (page 13) rather than the section on "Risk management and reinsurance" (page 14) leads to some confusion. We consider the setting of broad underwriting practices to be part of corporate governance and adherence to Sarbanes-Oxley requirements. There should be no attribution of profit for Head Office activities that constitute corporate governance activities.
- As a general comment, the insurance functions described in the Part IV Report seem to be oriented towards the P&C industry and are not necessarily complete or accurate for life insurance.



C. Application of the guidelines to insurance companies operating through subsidiaries

- We believe it is inappropriate for the Part IV Report to apply to transactions of separate legal entities. Transactions between related parties are more properly covered under transfer pricing guidelines.
- Accordingly we would like to see Section C of the Part IV Report removed.

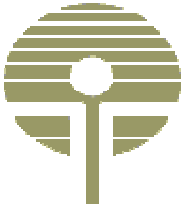
D. Applying the authorized OECD approach to insurance companies operating through PEs

Attribution of investment assets and risks

- The management of investments should not result in the attribution of profit. Compensation for the investment management function should be priced on an arm's length basis using third party comparables (i.e., investment management is typically a fee based service)
- In particular, the comment in paragraph 106 that “the asset management function has a prima facie link with market risk which might suggest that surplus should be attributed to the part of the enterprise which performs that function” is misleading and should be deleted. No surplus should be attributed to the investment management function of an insurance company – third party comparable pricing is the appropriate treatment for this function.
- The Part IV Report should specifically acknowledge that the management of investment assets in a jurisdiction is not indicative of where those assets should be taxed. Because of investment expertise and efficiencies of scale, investment assets may be managed in a different jurisdiction from where the insurance policy is written and the insurance risk is managed. However, the jurisdiction that bears the risk for the liability must also bear the investment risk on the asset.

Recognition of dealings

- The Part IV Report describes dealings between a PE and the rest of the enterprise as providing greater scope for tax-motivated transfers and requiring greater scrutiny. These comments are unsupported. Existing anti-avoidance legislation addresses this concern.



- Insurance enterprises operate within a highly regulated environment, where reinsurance transactions between a PE and the rest of the enterprise are generally required to be based on arm's length principles.
- We support the view that transactions between a PE and the rest of the enterprise should be documented and priced on an arm's length basis.

Agency PEs

- Agency PEs are discussed at length in Part I. We do not see a need for reiterating the discussion in Part IV, and recommend removing this section of the Part IV Report.

Key Entrepreneurial Risk-Taking Functions

- With respect to the determination of what functions constitute Key Entrepreneurial Risk-Taking functions ("KERTs") for an insurance company, the Part IV Report should specifically state that general functions (such as stewardship, control and back office) and investment management functions do not constitute KERTs. With respect to the investment management function, the fact that such services can be provided by outside third parties is a clear indication that they do not constitute a KERT to the insurance industry.

Capital allocation approach

- We agree that the allocation of surplus should not exceed the total surplus of the business as a whole. An allocation exceeding the aggregate surplus of the enterprise would result in double taxation.
- As acknowledged in the Part IV Report, there are no global standards for the attribution of capital or surplus in the insurance industry. Until such time as there are global standards, we agree that it is not possible to develop a single internationally accepted approach, and that application of the principles in practice must be flexible. However, without a single accepted approach we are concerned over the potential for double taxation, and the time and costs that will be incurred in seeking relief from competent authority.
- We agree that the "quasi-thin capitalization / regulatory minimum capital" approach (or use of the home office regulatory minimum when none exists in the PE) can be applied as a safe harbour. However, we also agree that there may be potential problems with this approach. Further development of these concepts and further



guidance is necessary.

- We endorse the important point made in paragraph 168 that, where double taxation may occur because countries adopt different authorized approaches in their domestic regimes and in view of Article 23 (“Capital”), “the home country should give relief for tax on profits calculated under the host country basis.”

Internal reinsurance

- Internal reinsurance is a critical tool in the management of global (re)insurance risks and provides a number of important business benefits, including operational and capital efficiencies, better pricing, and improved risk management.

Article 7(4)

- Apportionment under Article 7(4) offers a simplified approach (for some insurers) and is consistent with the notion of flexibility. Article 7(4) should be maintained in the OECD model tax convention until issues under Parts I to IV are adequately resolved and until a few years of enforcement have confirmed that the OECD guidelines under Part IV are being implemented consistently.

Thank you for providing us with the opportunity to comment on the draft Part IV Report. Given the significant issues still to be addressed, we trust that the industry will have further opportunities to comment on revised drafts of this paper before it is finalized.

Yours truly,

James S. Witol
Vice President, Taxation & Research