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FRANCE

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Dear Mr Owens

Report on the Attribution of Profits to a Permanent Establishment Part IV (Insurance)

We are writing with regard to the revised public discussion draft, issued in August this year and are pleased to have a further opportunity to comment. We appreciate the efforts of the OECD to engage in discussion with the industry and respond to the concerns raised last year. There have been significant changes to the draft guidance, and we regard the current version as much improved.

However we continue to have concerns in some areas. As you may already know, Lloyd's has a particular and unique structure and does not have the option to trade through subsidiaries. Therefore our international operations function through permanent establishments (PEs), which may arise through a fixed place of business, dependent agents and in some cases independent agents, where the treaty wording departs from the OECD model wording. We are aware that there may be other concerns raised by the draft which affect the broader insurance community, but we have restricted our comments to those relevant to Lloyd's business. In particular, we would direct you to our comments on independent agents and the allocation of assets held in trust where the guidance could easily produce anomalous results if taken out of context.

Key Entrepreneurial Risk Taking (KERT)

The revised version identifies the assumption of risk by performing the underwriting function as the only KERT (paragraph 69), this is based on the presumption in paragraph 94 that these activities constitute the most active decision-making functions relevant to the assumption of risk. We feel that this would be generally representative of the current Lloyd's business model, although this may not be true across all sectors of the insurance industry. However, future products or business models may develop where other activities should be regarded as a KERT. We therefore feel that Part IV should recognise the

possibility that there may be activities other than those set out in B-2i(c) which could be a KERT, and this would depend on the facts and circumstances, in line with the general considerations in Part I.

Section B-2i(c) sets out the key stages in the assumption of risk. While these activities may be the only KERT, it should not be assumed that all the activities of the KERT take place in only one location. The relative importance of each stage and where it is performed may vary depending on the type of product and insurance operation. For this reason, it is also reasonable that the tax and regulatory position may differ. This is the case for Lloyd's, where the activities are commonly split between the head office and the PE and this has historically been recognised for tax purposes. It is therefore right that the guidance recognises that a KERT may be split depending on the particular facts and circumstances, and that the profit attribution should be similarly split. In fact, we feel that this may be a common situation, with a particular relevance to agency PEs, and that there should be a greater emphasis on considering the split of profit.

We are concerned that the term "underwriting" is regarded as synonymous with the "assumption of risk", but it should be noted that the term may be used more narrowly in industry. We think it would reduce the potential for confusion if the section B-2i(c) were re-titled as "the assumption of insurance risk". This would be consistent with paragraphs 68, 69 and 94.

Dependent Agencies

The guidance is not intended to be used to determine whether a PE exists, rather this is a matter for individual treaties. Moreover, the guidance is limited to considering how much profit to attribute to a PE arising through a fixed place of business or a dependent agency PE as would be defined by Article 5 of the Model Tax Convention (paragraph 64). As stated in the guidance, some treaties depart from the standard wording for insurance and an agency PE may arise in circumstances that would not fall within Article 5(5), such as the collection of premiums or the sale of policies through an independent agent, and we will refer to these as independent agency PEs. In our view, the guidance is not relevant to independent agency PEs which are remunerated on arm's length terms, and there would not be a case to attribute profits to an independent agency PE.

We believe that the limitation of scope of the guidance is extremely important, and that this limitation should be set out clearly and much earlier in the document, possibly as a subsection of the introduction, to avoid it being applied inappropriately.

We are pleased to see the guidance confirm that there should be no "force of attraction" element in the authorised OECD approach (paragraph 110) between independent agents and dependent agency PEs.

However, we regard the concept of remunerating a PE for indirect benefits arising to an independent agent, discussed in C-1(i) (c) and (d), to be an area of future confusion, and

cannot find any comparable requirement in Parts I-III. There should be a clear and direct relationship between a PE's activities and the profit or remuneration to be attributed to it. We feel that introducing indirect and potentially unquantifiable benefits undermines the aim of providing greater clarity and certainty.

Asset allocation

The guidance explains at some length how "capital" should be allocated to a PE and we feel that the proposals are broadly sensible. We agree that capital may need to be allocated above the minimum regulatory requirements to reflect the commercial needs of the PE; similarly the PE should be able to benefit from the pooling advantages obtained as part of a large operation. The position of "trusteed assets" is discussed at paragraph 141, and this is an important issue for Lloyd's as we are required to hold significant assets in trust funds in various jurisdictions. For example, Lloyd's holds significant US assets in trust accounts, but these are required for both Lloyd's business written through the US PE and US business written from London. It is accepted that the location of risk may be different for tax and regulatory purposes, indeed the split KERT would not be a regulatory concept. Therefore we consider it highly likely for a situation to arise where the trusteed assets in the host state are greater than those attributed under a capital allocation method. We think it would be incorrect in principle to allocate all the trusteed assets in a host state to a PE where the tax and regulatory position diverge, and may not be the right solution even where they are similar.

Therefore, we think that the final sentence of paragraph 141 should be rephrased. Even where there is a reasonable alignment between regulation and tax, the level of trusteed assets in the host state may not represent a minimum level of assets to be allocated to the PE. As in other areas it will be important to look at the facts and circumstances behind the trusteed assets. While this should have regard to regulatory requirements, they should not be the determining factor.

Internal Dealings

We are concerned that the section on internal reinsurance is too brief. It could be helpfully expanded to provide greater clarity. Where the reinsurance function is located other than in the PE, we believe that the OECD intends to draw a distinction between reinsurance activities performed as part of the original risk assumption process and reinsurance taken out at a later time. In the first case, the activity may be a KERT and taken into account in considering where the profit should be attributed. But in the latter case, there is a general presumption that there would not be an internal reinsurance. We remain concerned that this presumption is not fully consistent with Part 1, and feel that the guidance should not have a general presumption against internal reinsurance. We feel that this area could be set out more explicitly. In particular Part IV could state clearly that, where the internal reinsurance is denied, the costs of any external reinsurance and any other ongoing risk

management functions located outside the PE should be taken into account in attributing profit to the PE, in line with Part I.

Lloyd's continues to be very interested in this issue, and would welcome an opportunity to attend the meeting on 26 November.

Yours sincerely

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