

KPMG LLP
Tax
1 Puddle Dock
London EC4V 3PD
United Kingdom

Tel +44 (0) 20 7311 1000
Fax +44 (0) 20 7311 3311
DX 38050 Blackfriars

Mr J. Owens
Director
Centre for Tax Policy and Administration
Organisation for Economic Cooperation and
Development
2, rue André Pascal
75775 Paris
FRANCE

16 September 2005

Dear Mr Owens,

OECD Discussion Draft of the Report on the Attribution of Profits to a Permanent Establishment – Part IV (Insurance) Issued June 27, 2005

This letter provides comments to the Discussion Draft of the Report on the Attribution of Profits to a Permanent Establishment - Part IV (Insurance). KPMG welcomes the OECD's efforts to draft a thoughtful analysis of the application of the authorised OECD approach to an insurance multinational enterprise.

As in the past, in commenting on the current draft, we have focused on the three aspects that are of most concerns to our clients in the insurance sector, namely

- Minimisation of double (or less than single) taxation;
- Administrative simplicity
- Obtaining broad international acceptance.

This response has been prepared by KPMG and focuses on issues arising from Part IV of the discussion draft. However, as in the case of our previous responses, comments made in the specific context of the Insurance sector may be of general application and should be construed accordingly.

1 Recharacterisation of transactions and dealings

Paragraph 68 suggests that tax authorities should challenge “whether or not the parties have entered into ceding arrangements which, viewed in their totality differ from those which would have been adopted by independent enterprises...”, this is further supported in paragraph 89 “...even transactions between associated enterprises may not be recognised where they do not take place under the normal commercial conditions that would apply between independent enterprises...” While in paragraph 182 the emphasis shifts “Except in the two circumstances outlined at paragraph 1.37¹, tax administrations should apply the guidance in paragraph 1.36 when attributing profit to a PE and so “should not disregard the actual *dealings* or substitute other *dealings* for them””.

There are many situations where a MNE will organise itself to benefit from its multi national structure and as such will perform transactions that would not be undertaken of it was not for the group relationship. This is recognised at paragraphs 1.36² and 1.39³: “Associated enterprises may and frequently do conclude arrangements of a specific nature that are not done or are very rarely encountered between unrelated parties.”

The thrust of the early sections of Part IV is an **extension** of the situations envisaged at paragraphs 1.36-1.41⁴ and it is not until later in the report that a more balanced view appears. It would be helpful to have the paragraph 182 comments made with the earlier comments regarding recharacterisation and for it to be made clear that Part IV is **not** seeking to go beyond the current understanding of the **limited** type of transaction/dealings that may be recharacterised.

2 Creditworthiness

Paragraph 86 states that “dealings between a PE and the rest of the enterprise of which it is a part should generally be priced on the basis that both share the same creditworthiness” while Paragraph 125 states that “the starting point of the authorised OECD approach is generally to attribute the same credit worthiness or solvency margin to the PE as enjoyed by the insurance enterprise as a whole”.

However paragraph 93 sets out “it is necessary under the first step of the authorised OECD approach to hypothesise the PE as a distinct and separate enterprise “engaged in the same or similar activities under the same or similar conditions” ”.

¹ OECD Transfer Pricing Guidelines for Multi-national Enterprises and Tax Administration

² OECD Transfer Pricing Guidelines for Multi-national Enterprises and Tax Administration

³ OECD Transfer Pricing Guidelines for Multi-national Enterprises and Tax Administration

⁴ OECD Transfer Pricing Guidelines for Multi-national Enterprises and Tax Administration

There appears to be conflict between the “separate enterprise” approach which would envisage differing credit worthiness of the PE and the enterprise, and Part IV which envisages that this would not arise other than in very specific situations.

3 Conflict with domestic legislation

One of the key objectives of Part IV should be the need to ensure a broad acceptance of the proposals by tax administrations around the world. The need to take into account domestic divergences can be illustrated by existing conflicts. For example, Paragraph 218 seems to envisage the potential payment of a royalty from the PE to the enterprise, a dealing which is specifically prohibited by UK domestic legislation.

Where local legislation conflicts with OECD guidance it would be helpful if the OECD could set out how it is expected that these conflicts will be resolved. It would assist if the OECD could identify those countries which will automatically follow the OECD attribution of profits to PEs papers, once they are finalised, and those countries where it will be necessary for there to be changes to domestic legislation and the relevant tax treaties before effect can be given.

It is clear that without a broad international consensus the scope for disputes and double taxation will increase.

4 Key Entrepreneurial Risk Takers (‘KERT’s’)

Paragraph 75 highlights that the “key entrepreneurial risk-taking functions are those which require active decision-making with regard to the taking on and day-to-day management of the individual risks and portfolio of risks” while paragraph 105 states that “rubber stamping” of a decision would not amount to performance of a key entrepreneurial risk taking function. The people centric approach at paragraph 75 suggests that physical presence is of utmost importance and that day-to-day decisions rather than strategic decisions are most important when determining the location of KERTs while paragraph 105 suggests that this may not always be the case. This is further apparent from paragraph 209 in which a case is given where "limit setting" might constitute a KERT. Although a case by case approach was also advocated in earlier parts of the Discussion Draft, the above passages suggest that the OECD now fully accepts the possibility that strategic management type functions can constitute KERT's (by way of comparison, see Part II, paragraph 12 and Part III, paragraph 76-79). While such an open approach is in principle welcomed, more guidance seems needed, tailored to the insurance industry, in order to avoid excessive uncertainty and the risk of double taxation this gives rise to.

The above-mentioned passage in paragraph 75 is also included in paragraph 10 of Part II. However, whereas Part II notes that it is the relative importance of the *functions* that determines whether or not they are KERT's, Part IV introduces an additional element, namely the relative



importance of the *risks*. While we can imagine that some form of correlation between the importance of a particular functions and risks can exist, it was not our understanding that the KERT principle should only be applied to some forms of risk-taking and not others. If this is indeed the intention, we would welcome an explanation as well as more detail on how to evaluate the different types of risk.

5 Documentation

Paragraph 169 suggests that The Mutual Agreement Procedure is available to resolve differences arising where countries incorporate different authorised approaches into their domestic regime. Such inconsistent approaches may lead to double taxation. Whilst we recognise this as a possible solution, it may be helpful to highlight that it will be easier for tax administrations to achieve a common understanding and hence single taxation if contemporaneous transfer pricing documentation is prepared.

6 CUPs

It would be helpful for the document to acknowledge the IRS services regulations which address the suitability of employing proprietary pricing models in the insurance industry for determining arm's length prices.

Yours Sincerely,

Erica Howard

Partner, Global Transfer Pricing Services
Tax & People Services

KPMG LLP (UK)