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Item 3(c) of the provisional agenda
Issues related to the United Nations Model Double Taxation Convention between Developed and Developing Countries

Co-Coordinators' Report: The treatment of income from cross-border insurance activities

Summary

This note is provided to the Committee for ***first discussion*** at its Twenty-seventh Session.

At its Twenty-fourth Session, the Committee approved the Subcommittee's work program, which included an item on the treatment of income from cross-border insurance activities. This note sets out the Subcommittee's proposal to delete paragraph 6 of Article 5 (which creates a deemed permanent establishment) and introduce a new paragraph 6 of Article 7 (which would allow taxation of the relevant premiums on a gross basis). The note also includes a draft of a proposed Commentary on both Articles 5 and 7 to explain the changes.

The Committee is asked to consider and give guidance on the following issues:

(a) whether it agrees with the Subcommittee's proposal in paragraph 28 to delete existing paragraph 6 of Article 5 and to introduce a new provision allowing gross-basis withholding tax as proposed in paragraph 28(a) of this note;

(b) if the Committee supports the approach set out in (a), whether the new provision should be included in Article 7 or, instead, in a new, stand-alone provision (such as an Article 12C);

(c) what are the circumstances in which an insurance enterprise will be viewed as "insuring risks in" a Contracting State, particularly in the case of reinsurance or direct insurance that covers multiple entities and/or countries; and

(d) whether the proposed Commentary on Articles 5 and 7 set out in paragraphs 29 and 30 adequately explain the proposed changes and whether there is additional guidance that would be helpful.

The Subcommittee looks forward to the Committee discussion and guidance.

I. Introduction

1. The United Nations Model Double Taxation Convention between Developed and Developing Countries (the UN Model) includes a special rule regarding insurance in the permanent establishment article. Under this provision, an enterprise of one Contracting State will be deemed to have a permanent establishment in the other Contracting State if it "collects premiums in the territory of that other State or insures risks situated therein through a person." This provision does not, however, apply to reinsurance transactions. As described in Section III, some countries, both developed and developing, choose not to include this provision, but include other provisions in their treaties to allow expanded source State taxation. Both the United Nations and the OECD have considered proposals to change the treatment of insurance in various ways.

2. Section II of this note provides background regarding how insurance companies operate and are structured, which give rise to tax concerns for many countries. Section III describes the history of provisions intended to address these concerns. Section IV describes the Subcommittee's proposed approach, while Section V provides proposed Commentary changes explaining the changes proposed in Section IV. Section VI includes questions for the Committee.

II. The Operation and Structure of Insurance Companies (including Reinsurance Companies)

3. The fundamental business of an insurance company is underwriting, the process of receiving remuneration for the willingness to take on a potential risk by promising to pay a customer if a loss from that risk is realized. The insurance company generally will employ "underwriters", professionals who evaluate and analyze the risks involved in insuring people and assets. Insurance underwriters establish pricing for accepted insurable risks.

4. From the perspective of the purchaser, insurance performs the function of protecting against the financial cost of an unexpected loss. Expanding access to insurance in developing countries therefore is connected to SDG 1, eradicating poverty, as an uninsured loss of a primary breadwinner, a home or a crop can plunge an entire family (back) into poverty. Therefore, life insurance, property and casualty insurance, agricultural insurance and other types of insurance perform an important societal function. Insurance companies are highly regulated because governments need to ensure that an insurance company will have sufficient assets to pay any claims that may arise.

5. Although the insurance company will establish the terms on which insurance may be sold, the policies will be sold either through the insurance company's own employee salespeople or through a network of brokers. These brokers may be dependent or independent agents within the meaning of Article 5 of tax treaties (at least before changes made to the UN Model and the OECD Model in 2017). Most countries require insurance companies selling to retail customers to do so through local subsidiaries or branches that are subject to local regulation. Reinsurance and some more specialized insurance (such as surplus lines, relating to potential losses too big for normal insurance companies) may not require such a physical presence.

6. Insurance generally involves both "risk shifting" and "risk distribution". Risk shifting is transferring the risk of loss from one party to another, such as from the insured to the insurer, and is sometimes an issue when considering captive insurance companies. Risk distribution is the pooling of independent risks of unrelated parties. An insurer can further reduce its overall risks by diversification, such as by writing homeowners' insurance in multiple markets. An insurer can also shift part of its risk through reinsurance, which effectively is insurance for insurers. Reinsurance therefore performs an important

business function by further distributing risk, allowing insurance companies to underwrite more risks and reducing costs.

7. Reinsurance can take several forms. First, a reinsurer may take on only specific risks (or a block of risks) from an insurer, through what is called "facultative" reinsurance, or may take on all risks incurred by the insurer during a specified period of time, pursuant to a "reinsurance treaty". In either case, the coverage may be "proportional" or "non-proportional". In the former case, the reinsurer may accept a certain percentage of all losses incurred by the insurance company. For example, a quota share treaty is a form of pro-rata reinsurance contract in which the insurer and reinsurer share premiums and losses according to a fixed percentage. In the latter case, the reinsurer will only be liable if the insurance company's losses exceed a certain amount. One common form of non-proportional insurance is "excess-of-loss" insurance, in which the reinsurer will pay the entire amount of the insurer's loss in excess of the agreed threshold. However, it is also possible for a reinsurer to take only a specific "slice" of losses or for different reinsurers to take different slices.

Example: Proportional vs. Excess of Loss

Insurance Company is a resident of Country A. It has entered into a "quota share" reinsurance treaty with Reinsurer, a resident of Country B, with respect to 25% of insurance written by Insurance Company during 2023 in exchange for a premium roughly equal to 25% of the insurance premiums received by Insurance Company. The reinsurance is recognized by Company A's insurance regulators and therefore reduces the amount of capital and reserves that Insurance Company is required to maintain, reducing Insurance Company's costs. Insurance Company's customers have claims of $5000x with respect to 2023, $1250 of which are reimbursed by Reinsurer.

In 2024, Insurance Company instead enters into an excess-of-loss reinsurance treaty with Reinsurer, under which Reinsurer agrees to reimburse Insurance Company for all losses in excess of $4000x. In 2024, claims against Insurance Company again equal $5000. Under the excess-of-loss reinsurance treaty, Reinsurer pays only $1000x.

In 2025, Insurance Company enters into a non-proportional reinsurance treaty with Reinsurer A, under which Reinsurer A will pay all losses above $4000x and below $5000x. Insurance Company also enters into an excess-of-loss reinsurance treaty with Reinsurer B with respect to any losses that exceed $5000x. The claims against Insurance Company again equal $5000x. Reinsurer A will pay $1000x to Insurance Company. Reinsurer B will not be required to make any payment.

8. Customers of an insurance company may, of course, pay premiums for years before an event giving rise to an insured loss occurs. Accordingly, another important source of income for an insurance company is investment income earned by investing premiums until such a loss occurs.[1] This investment income generally will be subject to tax at the time it is earned, even though it eventually may be used to pay out losses. This timing mismatch may be alleviated through the allowance of deductions for increases to reserves, but the rules for "reserving" vary considerably from country to country. If reserves are not

[1] It is not uncommon for a profitable insurance company to pay out losses that exceed the amount of the premiums it receives, with the shortfall more than made up through the insurance company's investment income.

allowed, then the insurance company is in effect taxable on "phantom income". One effect of entering into reinsurance contracts is that not only the risk, but also some of the cash that produces such investment income, is transferred to the reinsurance company through the payment of reinsurance premiums. For that reason, reinsurance companies usually are located in jurisdictions that do not impose income taxes or that have extremely generous reserving policies.

III. Provisions in Model and Bilateral Treaties to Address the Problem of Insurance

9. The first version of the UN Model, published in 1980, included the following provision relating to insurance in Article 5:

> 6. Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.

10. The reasons for the initial inclusion of this paragraph are described in the following paragraphs from the Commentary on Article 5 of the 1980 UN Model:

> This paragraph does not correspond to any provision of the OECD Model Convention. It was included because it was the common feeling of the Group that the OECD definition of permanent establishment was not adequate to deal with certain aspects of the insurance business. Members from developing countries pointed out that if an insurance agent was independent, the profits would not be taxable in accordance with the provisions suggested in article 5, paragraph 7, of the United Nations Model Convention (based on article 5, paragraph 6, of the OECD Model Convention); and if the agent was dependent, no tax could be imposed because insurance agents normally had no authority to conclude contracts as would be required under the provisions suggested in subparagraph 5 (a) (based on article 5, paragraph 5, of the OECD Model Convention). Those members expressed the view that taxation of insurance profits in the country where the premiums were being paid was desirable and should take place independently of the status of the agent. They therefore suggested that the United Nations Model Convention should include a special provision relating to insurance business. However, such taxation is based on the assumption that the person (employee or representative) through whom premiums are collected and risk insured, is present in the country where the risk is located.
>
> Once agreement had been reached on the principle of including a special provision on insurance, the discussion in the Group focused mainly on cases involving representation through "an independent agent". Members from developing countries felt it would be desirable to provide that a permanent establishment existed in such cases because of the nature of the insurance business, the fact that the risks were situated within the country claiming tax jurisdiction, and the facility with which persons could, on a part-time basis, represent insurance companies on the basis of an "independent status", making it difficult to distinguish between dependent and independent insurance agents. Members from developed countries, on the other hand, stressed that in cases involving independent agents, insurance business should not be treated differently from such activities as the sale of tangible commodities. Those members also drew attention to the difficulties involved in ascertaining the total amount of business done when the insurance was handled by a number of independent agents within the same country. In view of the difference in

> approach, the group agreed that the case of representation through independent agents should be left to bilateral negotiations, which could take account of the methods used to sell insurance and other features of the insurance business in the countries concerned.

These paragraphs were unchanged in the Commentary on paragraph 6 of Article 5 of the 2001 UN Model.

11. Some participants in the Subcommittee noted that it is also important to consider how much taxable net profit might be reported by a permanent establishment deemed to exist by application of Article 5(6). The Commentary to Article 7 of the UN Model does not provide guidance regarding the determination of the profits of a permanent establishment that is deemed to exist by reason of paragraph 6. The UN Model retains Article 7(4), allowing for an apportionment of the total profits of an enterprise, a provision that sometimes is used with respect to insurance companies.[2] Moreover, in the example set out in the box above, the profits of Insurance Company would be reduced by the premiums paid to Reinsurer, but Country A would not have been able to tax Reinsurer on those premiums. This would also be true if Insurance Company were a resident of another country, operating through a branch in Country A. Therefore, depending on their domestic law, some countries may find that the inclusion of paragraph 6 of Article 5 in their bilateral treaties does not result in significantly increased tax revenues.

12. Although the OECD Model does not include a provision similar to paragraph 6 of Article 5, the Commentary acknowledged the problem presented by the use of agents by insurance companies in paragraph 21 of the Commentary on paragraph 5 of Article 5 of the 1963 OECD Draft Double Taxation Convention on Income and on Capital, which stated:

> The special problems which can arise in the case of insurance companies dealing by means of intermediaries or variously qualified representatives shall be further studied.

The Commentary on paragraph 5 of Article 5 of the 1977 OECD Model Double Taxation Convention on Income and on Capital included a more extensive analysis of the issue:

> 38. According to the definition of the term "permanent establishment" an insurance company of one State may be taxed in the other State on its insurance business, if it has a fixed place of business within the meaning of paragraph 1 or if it carries on business through a person within the meaning of paragraph 5. Since agencies of foreign insurance companies sometimes do not meet either of the above requirements, it is conceivable that these companies do large-scale business in a State without being taxed in that State on their profits arising from such business. In order to obviate this possibility, various conventions concluded by OECD Member countries include a provision which stipulates that insurance companies of a State are deemed to have a permanent establishment in the other State if they collect premiums in that other State through an agent established there--other than an agent who already constitutes a permanent establishment by virtue of paragraph 5--or insure risks situated in that territory through such an agent. The decision as to whether or not a provision along these lines should be included in a convention will depend on the factual and legal situation prevailing in the Contracting States concerned. Frequently, therefore, such a provision will not be contemplated. In view of this fact, it did not seem advisable to insert a provision along these lines in the Model Convention.

[2] See paragraph 27 of the Commentary on Article 7 of the UN Model, quoting paragraph 54 of the Commentary on Article 7 of the 2008 OECD Model.

13. In 2011, the Commentary on the UN Model relating to insurance companies was modified to include the paragraph quoted in paragraph 11 from the OECD Commentary (now re-numbered paragraph 114), along with the following explanatory introduction:

> Paragraph 6 of the United Nations Model Convention, which achieves the aim quoted above, is necessary because insurance agents generally have no authority to conclude contracts…

Accordingly, to this point, the issue identified related solely to the problem of conducting business through agents.

14. The OECD also returned to the issue of when an agent of an insurance enterprise will cause the enterprise to have a permanent establishment in 2011. In the public discussion draft, *Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention,* the issue was described as follows:

> **25. Activities of insurance agents**
>
> ***Description of the issue***
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> 135. To what extent do activities of local insurance agents who refer contracts for final approval by the foreign insurance company create a permanent establishment?
>
> 136. The issue is illustrated by the following example developed in the course of the preparation of the branch reports and general report on the topic "Is there a Permanent Establishment?' for the IFA 2009 Congress:
>
> ***Insurance agents***
>
> ICO is a life insurance company resident in State R. It sells life insurance in State S through agents. All the agents work out of their private homes and thus do not need separate offices. Some minor paper work is done at home. None of the agents are employed by ICO but they work solely for ICO. The agents offer insurance policies on behalf of ICO, receive the applications from the clients and send them over to ICO in State R. The insurance policy is not in force until ICO has received and reviewed the medical information related to each client. In the meantime, a temporary life insurance policy is in force. This policy is automatically terminated when the draft policy is approved or rejected by ICO. Over time, ICO rejects some 10 per cent of the policies submitted by the agents.
>
> ***Recommendation of the Working Group***
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> 137. The Working Group concluded that this issue was basically a policy question: whether the conclusion expressed in paragraph 39 of the Commentary that "it did not seem advisable to insert a special provision for insurance agents"– was still shared by the member States. Since few countries included such a special provision in their treaties, it was agreed that no changes should be made to the Commentary with respect to this issue.

This example appears to be based on *Canada vs Knights of Columbus*[3] in which the taxpayer, a U.S. fraternal organization with hundreds of agents selling insurance in Canada, was found not to have a permanent establishment in Canada.

15. In the 2014 public discussion draft on *BEPS Action 7: Preventing the Artificial Avoidance of PE Status*, there is a discussion not only of the problem of when the activities of an agent will cause an insurance enterprise to have a permanent establishment, but also a short mention of the problem of reinsurance:

> 38. A provision dealing exclusively with the situation of dependent agents who do not formally conclude insurance contracts would likely address cases where a large network of exclusive agents is used to sell insurance for a foreign insurer.
>
> 39. Existing tax treaties include a few examples of provisions dealing with insurance. A number of treaties include provisions similar to those found in the UN Model, sometimes without a specific exception for re-insurance. Other provisions exclude any form of insurance of local risks (other than life insurance) from any limitation imposed by Art. 7 and, therefore, allow source taxation of insurance profits from insuring such local risks regardless of whether or not the profits are attributable to a PE. Such provisions may be subject to a standstill clause or may limit the tax to a certain percentage (e.g. 10%) of the gross premiums if the profits are not attributable to a PE.
>
> 40. Insurance (including re-insurance) raises difficult issues as regards the question of where profits that represent the remuneration of risk should be taxed. As recognised in Actions 4 and 9 of the Action Plan, BEPS issues arise in relation to the transfer of risk within a multinational group, including through insurance and re-insurance.
>
> 41. Since the PE threshold relates to activities carried on in a State, a change to the PE threshold would not address cases where the remuneration of risk is shifted through the payment of insurance or re-insurance premiums to an associated enterprise that performs no functions in a State. It might therefore be more appropriate to address the BEPS concerns related to such cases through the adjustment of the profits of the local enterprise from which the risk-remuneration is being shifted. This could be done through transfer pricing or special measures (e.g. addressing the deductibility of insurance or re-insurance premiums paid to related parties), as contemplated under Actions 4 and 9 of the Action Plan. In the case of transfer of risk to an independent party that can be done through bona fide insurance or re-insurance, the most significant BEPS concern seems to be related to the possibility that an insurance enterprise could actively sell insurance or re-insurance in a country through the use of exclusive agents without having a PE in that State.
>
> 42. Based on this analysis, the Focus Group concluded that the following two alternative approaches could be adopted in order to deal with BEPS concerns related to the artificial avoidance of the PE threshold in relation to insurance activities…

The two alternatives were to include a provision such as paragraph 6 of Article 5 of the UN Model, or not to include any provision specific to insurance but to rely instead on other changes made to Article 5 as part of the BEPS project.

[3] May 2008, Tax Court, Case No. 2008TCC307.

16. Public comments on the Action 7 discussion draft made several points in arguing against the addition to the OECD Model of a provision such as paragraph 6 of Article 5 of the UN Model. In particular, many of those commenting pointed out that the collection of insurance premiums does not constitute a "key entrepreneurial risk-taking function" (KERT), as described in Part IV of the *Report on the Attribution of Profits to Permanent Establishments*. As a result, they argued, the creation of a permanent establishment would increase administrative burdens on insurance companies but be unlikely to result in increased revenue to the host State. Of course, the Committee of Experts rejected the Authorised OECD Approach to Article 7 some years ago so that argument is not dispositive with respect to the equivalent paragraph in the UN Model. Some commenters pointed out that many countries, particularly in Europe, have insurance premium taxes that apply whenever an insured risk is located in that country. One or two pointed out that there is no difference between insurance and reinsurance – reinsurance is the means by which insurance companies shift risk to other companies to achieve risk diversification – effectively insuring themselves against excessive loss.

17. Most stakeholders argued that there was no need or justification for including a special rule for insurance companies. However, in many cases those comments went on to argue against different versions of the dependent agent provision on the grounds that those provisions could result in permanent establishments for insurance enterprises that had entered into "quota share" reinsurance treaties with insurance companies located in a host State or had outstanding "delegated underwriting authority" with agents therein. The existence of these common types of arrangements in the insurance industry might reasonably have been seen as justification for a different approach to the industry. Nevertheless, the Action 7 Final Report rejected a specific rule applicable to insurance companies with the following explanation:

> ***2. Strategies for selling insurance in a State without having a PE therein***
>
> 18. As part of the work on Action 7, BEPS concerns related to situations where a large network of exclusive agents is used to sell insurance for a foreign insurer were also examined. It was ultimately concluded, however, that it would be inappropriate to try to address these concerns through a PE rule that would treat insurance differently from other types of businesses and that BEPS concerns that may arise in cases where a large network of exclusive agents is used to sell insurance for a foreign insurer should be addressed through the more general changes to Art. 5(5) and 5(6) in section A of this report.

Thus, the OECD final report once again focused on the agency issue and not on the base eroding risks from reinsurance.

18. In connection with its own work on BEPS, the Committee of Experts considered a proposal to expand the existing provision to include reinsurance as well as direct insurance, "[d]ue to the Committee's concerns that Article 5(6) can be abused and avoided in relation to re-insurance."[4] If this change had been adopted, it would have allowed the host State to treat the reinsurance enterprise as having a permanent establishment, but would not have addressed the problem described in the public comments regarding the determination of the profits of the permanent establishment.

19. The arguments for and against the deletion of the exception for reinsurance are described in E/C.18/2016/CRP.10, the report of the Coordinator of the Subcommittee on Base Erosion and Profit Shifting, in what was proposed to be the Commentary explaining this change:

> 29. Some countries, however, favour extending the provision to allow taxation even where there is representation by such an independent agent. They take this approach because of

[4] E/C.18/2016/CRP.10.

> the nature of the insurance business, the fact that the risks are situated within the country claiming tax jurisdiction, and the ease with which persons could, on a part-time basis, represent insurance companies on the basis of an "independent status", making it difficult to distinguish between dependent and independent insurance agents. Other countries see no reason why the insurance business should be treated differently from activities such as the sale of tangible commodities. They also point to the difficulty of ascertaining the total amount of business done when the insurance is handled by several independent agents within the same country. In view of this difference in approach, the question how to treat independent agents is left to bilateral negotiations, which could take account of the methods used to sell insurance and other features of the insurance business in the countries concerned.

20. A related proposal considered by the Committee of Experts would have added an alternative provision to the Commentary on Article 5 which would allow taxation by the source State of profits derived from the insurance business even in the absence of a permanent establishment. The relevant paragraph would have read as follows:

> 30. To address the difficulties faced in administering a provision that deems an insurance business to constitute a permanent establishment, for example in relation to the attribution of profits, some countries may instead prefer to include in Article 7 a provision which provides the source country with the right to tax insurance businesses without deeming a permanent establishment to exist. Some countries may prefer to include a maximum rate of taxation permitted in the source country, with the rate to be determined in bilateral negotiations.
>
>> []. Notwithstanding the other provisions of this Article, an enterprise of a Contracting State that derives profits from any form of insurance, in the form of collecting premiums or insuring risks in the other Contracting State, may be taxed on such profits in that other Contracting State. However, the tax in the other Contracting State may not exceed ___ percent of the premiums collected.

It should be noted that this provision does not include the words "through a person", which appears in paragraph 6 of Article 5 of the UN Model; some participants in the Subcommittee have indicated that the meaning of those words is somewhat unclear to them.

21. The proposal to include in the Commentary the alternative provision set out in paragraph 20 was approved at the 13th session of the Committee.[5] However, at its 14th Session, the Committee agreed to make no changes to the insurance provisions of the 2017 version of the UN Model but to add the issue of insurance to the agenda for the next meeting of the Committee.[6] The last membership of the Committee did not take up work on the issue "[d]ue to other priorities,"[7] but continued to include it in the list of issues that might be taken up by the next (this) membership of the Committee.

22. At its meeting in June 2023, the Subcommittee considered the drafting of a provision similar to that in paragraph 20. It noted that the paragraph effectively included two thresholds – "profits" and "premiums", while other provisions that allow for gross basis taxation do not consider whether the recipient is in a profit or loss position.

[5] Paragraph 68 of E/2016/45-E/C.18/2016/7.
[6] Paragraph 54 of E/2017/45-E/C.18/2017/3.
[7] Paragraph 37 of E/C.18/2020/CRP.37

23. Finally, as noted in the United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries, “Some countries take a broader approach and simply exclude the profits of insurance enterprises from the application of the treaty, leaving these profits to be taxed in accordance with domestic law.” Such a provision can be found in paragraph 6 of the protocol to the 2003 treaty between Chile and New Zealand, which reads:

> Income, premiums or profits from any kind of insurance may be taxed in accordance with the laws of either Contracting State.

IV. Proposed Approach

24. The preceding description of various attempts to address the allocation of taxing rights from insurance activities demonstrates that many countries have significant concerns about what is a highly mobile industry. At the same time, there is a legitimate concern among stakeholders that changes to the UN Model should not affect legitimate business transactions, such as reinsurance contracts with unrelated parties that serve to shift and distribute risk to the benefit of the entire insurance industry.

25. The general changes made to Article 5 in both the OECD Model and the UN Model in response to the BEPS project may have addressed the specific issue of the network of exclusive agents presented in the *Knights of Columbus* case. However, the other issues discussed above have not been addressed.[8]

26. The Subcommittee also identified an additional issue, which is that the different ways that insurance premiums are taxed in different countries may result in unintentional asymmetries in tax treaties. Some countries impose taxes on insurance premiums in the form of an income tax, which usually is collected through a withholding tax; in many countries, a general withholding tax on all payments made by their residents or borne by permanent establishments situated therein would apply also to insurance premiums. Other countries impose excise taxes or other indirect taxes on insurance premiums[9] or policies.[10] In the case of a bilateral tax treaty entered into between two countries with different systems, it is possible that the taxing rights of a country that imposes a withholding tax could be limited while those of a country that imposes an excise tax would not be. It appears that this is an issue that should be addressed, either in the Commentary to the UN Model or in the Manual (or both), no matter what decision is taken with respect to the other issues set out in this note.

27. If State W imposes an income tax, in the form of a withholding tax, on insurance premiums and State X an excise tax, then one option is to include both taxes as covered taxes in Article 2. In that case, if the treaty included paragraph 6 of Article 5, then an insurance company that is a resident of State X would

[8] For example, some years ago U.S.-based insurance companies complained that U.S. subsidiaries of foreign insurance companies were entering into quota share reinsurance contracts that resulted in substantial amounts of profits being shifted to low-tax jurisdictions. Under these “reinsurance treaties”, a specified percentage of each risk underwritten by the U.S. affiliate would automatically be reinsured with the non-U.S. affiliate. In many cases, the U.S. affiliates had large local staffs that would interact with customers, performing most of the insurance functions. However, the reinsurance treaties often provided for very large “quotas” (sometimes as high as 75%) being reinsured in the low-tax affiliates, which usually had quite small staffs. It is worth noting that, although it is not certain whether the quota share reinsurance treaty will result in profits or losses in any particular year, over time most insurance companies generate profits. This loophole, identified in the late 1990s, appears finally to have been addressed in the United States by the enactment of the Base Erosion and Anti-abuse Tax in 2017. It also is possible that some provisions of Pillar Two developed by the Inclusive Framework on BEPS, if adopted widely, might also address the problem in other countries.
[9] In Europe, these frequently are referred to simply as “insurance premium taxes”.
[10] See Section 4371 of the U.S. Internal Revenue Code (Policies Issued by Foreign Insurers).

be subject to tax on the profits attributable to the deemed permanent establishment in State W. An insurance company that is a resident of State W would be subject to the State X excise tax because it is deemed to have a permanent establishment, allowing the imposition of the tax. Alternatively, if both taxes are covered taxes but the treaty includes a provision such as in paragraph 20, the negotiated rate would apply to amounts paid to each insurance company. Finally, if the treaty excluded both taxes from Article 2, then each of State W and State X could apply its domestic law without limit.

28. The Subcommittee therefore proposes the following changes to the UN Model to address the treatment of insurance:

a. Paragraph 6 of Article 5 would be deleted from the text of the UN Model and the following provision would be added to Article 7, with existing paragraph 6 renumbered as paragraph 7:

> [6]. Notwithstanding the other provisions of this Article, an insurance enterprise of a Contracting State that collects premiums from, or insures risks in, the other Contracting State (including through reinsurance) may be taxed on the premiums arising from such activities. However, if the enterprise is the beneficial owner of the premiums, the tax in the other Contracting State may not exceed ___ per cent *[the percentage is to be established through bilateral negotiations]* of the premiums collected.

b. The Commentary on the new paragraph in Article 7 would discuss the problem of asymmetry and suggest that countries may want to consider that problem when drafting Article 2 (Covered Taxes) to maintain reciprocity in this area;

c. Paragraph 2 of Article 23 A would be amended to include a reference to Article 7(6); and

d. The existing paragraph 6 of Article 5 (without the exemption for reinsurance) would be included as an alternative provision in the Commentary to Article 5.

V. Draft Commentary

29. The changes described in paragraph 28 would require some consequential changes to the Commentaries on Articles 5 and 7. For example, the Subcommittee proposes the following changes to the Commentary on Article 5:

Insurance Activities

71. ***Until [202-], t***~~T~~his ***article contained a paragraph intended*** ~~paragraph of the United Nations Model Tax Convention does not correspond to any provision in Article 5 of the OECD Model Tax Convention and is included~~ to deal with certain aspects of the insurance business. ***The prior paragraph read:***

> ***6. Notwithstanding the preceding provisions of this Article but subject to the provisions of paragraph 7, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in***

> ***the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.***

This paragraph was included because of concerns that insurance companies could do large-scale business in a State without being taxed in that State in the absence of a fixed place of business. This is ~~Paragraph 114 of the Commentary on Article 5 of the 2017 OECD Model Tax Convention nevertheless discusses the possibility of including such a provision in bilateral tax treaties in the following terms:~~

> ~~114. According to the definition of the term "permanent establishment" an insurance company of one State may be taxed in the other State on its insurance business, if it has a fixed place of business within the meaning of paragraph 1 or if it carries on business through a person within the meaning of paragraph 5. Since agencies of foreign insurance companies sometimes do not meet either of the above requirements, it is conceivable that these companies do large-scale business in a State without being taxed in that State on their profits arising from such business. In order to obviate this possibility, various conventions concluded by OECD member countries before 2017 include a provision which stipulates that insurance companies of a State are deemed to have a permanent establishment in the other State if they collect premiums in that other State through an agent established there – other than an agent who already constitutes a permanent establishment by virtue of paragraph 5 – or insure risks situated in that territory through such an agent. The decision as to whether or not a provision along these lines should be included in a convention will depend on the factual and legal situation prevailing in the Contracting States concerned. Also, the changes to paragraphs 5 and 6 made in 2017 have addressed some of the concerns that such a provision is intended to address. Frequently, therefore, such a provision will not be contemplated. In view of this fact, it did not seem advisable to insert a provision along these lines in the Model Convention.~~

~~72. Paragraph 6 of the United Nations Model Tax Convention, which achieves the aim quoted above, is necessary~~ because insurance agents ~~generally have no~~ ***may be seen as not having*** authority to conclude contracts; ~~thus~~***if that is the case***, the conditions of paragraph 5(*a*) would not be fulfilled. ***Moreover, i***~~I~~f an insurance agent is independent~~, however~~, the profits of the insurance company attributable to his activities are not taxable in the source State because the provisions of paragraph 7 of Article 5 would be fulfilled and the enterprise would not be deemed to have a permanent establishment.

7***2***~~3~~. ***The prior paragraph was included in Article 5 because s***~~S~~ome ***members of the prior Ad Hoc Group***~~countries, however,~~ favour***ed*** extending the provision to allow taxation even where there is representation by such an independent agent. They ~~take~~***believed*** this approach ***was appropriate*** because of the nature of the insurance business, the fact that the risks are situated within the country claiming tax jurisdiction, and the ease with which persons could, on a part-time basis, represent insurance companies on the basis of an "independent status", making it difficult to distinguish between dependent and independent insurance agents. Other ***members of the Ad Hoc Group saw*** ~~countries see~~ no reason why the insurance business should be treated differently from activities such as the sale of tangible commodities. ***In [202], Members of the Committee agreeing with this latter point*** ~~They~~ also ***noted that the changes to paragraphs 5 and 6 made in 2017 have addressed some of the concerns that such a provision is intended to address.*** ~~point to the difficulty of ascertaining the total amount of business done when the insurance is handled by several independent agents within the same country. In view of this difference in approach, the question how to treat independent agents is left to bilateral negotiations, which could take account of the methods used to sell insurance and other features of the insurance business in the countries concerned.~~

73. Some Members of the Committee have concerns that go beyond the agency questions set out above. They believe that it is also important to consider how much taxable net profit might be reported by a permanent establishment deemed to exist by application of Article 5(6). The Commentary to Article 7 of the UN Model does not provide guidance regarding the determination of the profits of a permanent establishment that is deemed to exist by reason of paragraph 6. The UN Model retains Article 7(4), allowing for an apportionment of the total profits of an enterprise, a provision that sometimes is used with respect to insurance companies.[11] These Members also note that, if a resident insurance company reinsures its risk with a reinsurance company in the other country, the profits of that insurance company will be reduced by the premiums paid to the reinsurance company, but under the prior paragraph 6, the source country would not have been able to tax the reinsurance company on those premiums. This would also be true if the insurance company were a resident of another country, operating through a branch in the source State. Therefore, depending on their domestic law, some countries may find that the inclusion of the prior paragraph 6 of Article 5 in their bilateral treaties does not result in significantly increased tax revenues.

74. One approach that deals only with the reinsurance question set out in paragraph 73 would be to include the provision from the prior paragraph 6 without the exception for re-insurance. Such a provision would read:

> *6. Notwithstanding the preceding provisions of this Article but subject to the provisions of paragraph 7, an insurance enterprise of a Contracting State shall be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.*

75. However, the Committee viewed this approach as only a partial solution to the problem of taxing insurance companies as it would not resolve any of the difficult issues regarding the determination of the profits to be taxed under Article 7. Accordingly, in 202[-], a new paragraph 6 was added to Article 7 of the UN Model to allow for gross-basis source State taxation of insurance, including re-insurance, premiums without regard to whether the relevant insurance or reinsurance company has a permanent establishment in that State. Therefore, the alternative provisions set out in paragraph 71 and 74, which require net basis taxation, should not be included in a bilateral treaty that includes paragraph 6 of Article 7.

76. In deciding on the best approach to insurance enterprises, countries may want to consider an additional issue, which is that the different ways that insurance premiums are taxed in different countries may result in unintentional asymmetries in tax treaties. The prior paragraph 6 of Article 5 would restrict the source State's right to tax only in cases where the tax imposed with respect to the premiums is a covered tax under Article 2. This is likely to be the case if a Contracting State imposes taxes on insurance premiums in the form of an income tax, such as a gross-basis withholding tax. However, many countries impose excise taxes or other indirect taxes on insurance premiums or policies. In the case of a bilateral tax treaty entered into between two countries with different domestic law systems for taxing insurance premiums, it is possible that the

[11] See paragraph 27 of the Commentary on Article 7 of the UN Model, quoting paragraph 54 of the Commentary on Article 7 of the 2008 OECD Model.

taxing rights of a country that imposes a withholding tax could be limited while those of a country that imposes an excise tax would not be. Countries may want to consider these differences while drafting Article 2 in order to avoid inadvertent asymmetric treatment under their treaties.

77. For example, if State W imposes an income tax, in the form of a withholding tax, on insurance premiums and State X imposes an excise tax, then one option is to include both taxes as covered taxes in Article 2. In that case, if the treaty included paragraph 6 of Article 5, then an insurance company that is a resident of State X would be subject to tax on the profits attributable to the deemed permanent establishment in State W. An insurance company that is a resident of State W would be subject to the State X excise tax because it is deemed to have a permanent establishment, allowing the imposition of the tax. Alternatively, if the treaty excluded both taxes from Article 2, then each of State W and State X could apply its domestic law without limit.

30. The Subcommittee proposes the following changes to the Commentary on Article 7:

Paragraph 6

29. This paragraph of the United Nations Model Tax Convention does not correspond to any provision in Article 7 of the OECD Model Tax Convention and was added to the UN Model in 202[ ] to replace paragraph 6 of Article 5. Paragraph 6 of Article 5 had provided an expanded definition of permanent establishment that would have allowed taxation of certain profits from insurance activities in the host State even in the absence of a fixed base or a dependent agent. A special provision addressing the taxation of insurance premiums was included because of concerns that insurance companies could do large-scale business in a State without being taxed in that State on their profits arising from such business.

30. However, paragraph 6 of Article 5 created a permanent establishment and therefore required taxation on a net basis of the profits of the permanent establishment as determined under Article 7. The Committee decided to replace paragraph 6 of Article 5 with paragraph 6 of Article 7 to avoid the need to determine the profits of a permanent establishment in those circumstances. Paragraph 6 of Article 7 allows certain premium payments received by insurance or reinsurance companies to be taxed by a Contracting State on a gross basis and does not require any threshold, such as a permanent establishment or fixed base, as a condition for the taxation of such payments. Paragraph 6 therefore serves the same function with respect to insurance and reinsurance premiums as other articles do with respect to dividends, interest, royalties, fees for technical services and payments underlying income from automated digital services.

31. Paragraph 6 of Article 7 establishes that premiums for insurance or reinsurance may be taxed in the State in which the insurance enterprise collects premiums or insures risks. It does not, however, provide that such premiums are taxable exclusively by that State. Such premiums may also be taxed in the State of residence of the beneficial owner of the premiums.

32. The paragraph also establishes the principle that the Contracting State from which the premiums are collected or in which the insured risks are located may tax the related premium payments in accordance with the provisions of its domestic law. However, if

the beneficial owner of the premiums is an enterprise of the other Contracting State, the amount of tax imposed by the other State may not exceed a maximum percentage, to be established through bilateral negotiations, of the gross amount of the premiums.

33. When considered in conjunction with Article 23 (Methods for the elimination of double taxation), paragraph 6 of Article 7 establishes the primary right of the country from which the premiums are collected or in which the insured risks are located to tax those payments in accordance with its domestic law (subject to the limitation on the maximum rate of tax if the beneficial owner of the premiums is an enterprise of the other Contracting State). Accordingly, the country in which the recipient of those premiums is resident is obligated to prevent double taxation of those premiums. Under Article 23 A or 23 B, the residence country is required to provide relief from double taxation through the exemption of the income or the granting of a credit against any tax payable to the residence country for any tax imposed on that income by the other Contracting State in accordance with the convention. In this regard, where a country generally applies the exemption method under Article 23 A, it is nevertheless entitled to apply the credit method under paragraph 2 of Article 23 A with respect to items of income taxable under paragraph 6.

34. Paragraph 6 applies even if the recipient insurance enterprise has a permanent establishment in the other Contracting State and the premiums would be treated as the income of that permanent establishment. Countries that wish to change that result may use the following language:

> ***Notwithstanding the other provisions of this Article, an insurance enterprise of a Contracting State that collects premiums from, or insures risks in, that other State (including through reinsurance) may be taxed on the premiums arising from such activities. However, in that case, if the enterprise is the beneficial owner of such premiums, the tax in the other Contracting State may not exceed ___ per cent [the percentage is to be established through bilateral negotiations] of the premiums collected. This paragraph will not apply if the insurance enterprise has a permanent establishment in the other Contracting State within the meaning of Article 5 and the insurance (including reinsurance) premiums would be treated as income of that permanent establishment under the other provisions of this Article.***

This alternative would result in the same relationship between taxation on a net basis and taxation on a gross basis that exists under provisions such as Articles 10, 11, 12, 12A and 12B.

35. [Reserved for guidance regarding meaning of "collects premiums from" and "insures risks in".]

[NB: The Subcommittee will continue to discuss the meaning of the two terms referred to in paragraph 35.]

36. Paragraph 6 of Article 7 will restrict the source State's right to tax only in cases where the tax imposed with respect to the premiums is a covered tax under Article 2. This is likely to be the case if a Contracting State imposes taxes on insurance premiums in the form of an income tax, such as a gross-basis withholding tax. However, many countries impose excise taxes or other indirect taxes on insurance premiums or policies. In the case of a bilateral tax treaty entered into between two countries with different

domestic law systems for taxing insurance premiums, it is possible that the taxing rights of a country that imposes a withholding tax could be limited while those of a country that imposes an excise tax would not be. Countries may want to consider these differences while drafting Article 2 in order to avoid inadvertent asymmetric treatment under their treaties.

37. For example, if State W imposes an income tax, in the form of a withholding tax, on insurance premiums and State X an excise tax, then one option is to include both taxes as covered taxes in Article 2. In that case, under paragraph 6 of Article 7, the negotiated rate would apply to amounts paid to each insurance company. Alternatively, if the treaty excluded both taxes from Article 2, then each of State W and State X could apply its domestic law without limit.

VI. Issues for the Committee

31. The Committee is asked to consider and give guidance on the following issues:

(a) whether it agrees with the Subcommittee's proposal in paragraph 28 to delete existing paragraph 6 of Article 5 and to introduce a new provision allowing gross-basis withholding tax as proposed in paragraph 28(a) of this note;

(b) if the Committee supports the approach set out in (a), whether the new provision should be included in Article 7 or, instead, in a new, stand-alone provision (such as an Article 12C);

(c) what are the circumstances in which an insurance enterprise will be viewed as "insuring risks in" a Contracting State, particularly in the case of reinsurance or direct insurance that covers multiple entities and/or countries; and

(d) whether the proposed Commentary on Articles 5 and 7 set out in paragraphs 29 and 30 adequately explain the proposed changes and whether there is additional guidance that would be helpful.