BASE EROSION & PROFIT SHIFTING

UPDATE

THE PROBLEM

"The OECD conservatively calculates that governments are losing up to ¼ of a trillion dollars of tax revenues annually due to these practices."

The OECD report on Base Erosion & Profit Shifting (BEPS) – that is using financial vehicles to transfer money and thus avoid tax – specifically mentioned captives as a potential way of doing this.

OECD and G20 collaborating at least until 2020. This means that captives will be scrutinised particularly for their legitimacy and business practices. Captive owners now have the burden of proof on them, so will have to pro-actively demonstrate that their captive was created for legitimate risk management reasons and not as a part of a tax planning strategy.

Base Erosion and Profit Shifting (BEPS): Key Captive Considerations

Specific reference to captives in BEPS as potential for tax avoidance:

- Action 3: income from captive insurance and reinsurance under Controlled Foreign Corporation (CFC) rules through release of dividends, interest, insurance income, royalties, sales/service income.
- Action 4: using interest payments and deductions to finance deferred income or other types of interest payment. Transfer pricing guidance being developed specifically on captives, with no exclusions.
- Action 5 update: Hong Kong profits tax concession for captives, and the Mauritius insurance regime, are being reviewed and amended as a result of BEPS.
- Action 11: suggestion that captive insurance payments could be used for 'possible mispricing induced by tax rate differentials', as well as reiteration action 3 suggesting income from captives fits the description of income from CFCs and raises BEPS concerns.

WHAT DOES THAT MEAN FOR CAPTIVE OWNERS?

There are many ways for captive owners to be proactive by considering the following elements:

Strategy and substance:

Being able to clearly articulate a strategy and having documentation regarding the substance of the captive is extremely important.

- Domicile choice: are you able to demonstrate a legitimate business decision for placing the captive in your selected domicile, such as other business activity in the domicile.
- Are day-to-day and strategic decisions made in the domicile?
- Is the board experienced and suitable to make decisions and manage a captive?
- Does the cost of local activity align with profit?
- Is value created in the domicile?
- What is your captive strategy? Is it demonstrable?
- Is the governance documented?
- Is retention suitable and in line with your risk tolerance and overall philosophy?
- Is capitalisation suitable and appropriate?

Pricing:

Where transfer pricing doesn't reflect the market or arm's length principle, taxes could subsequently be mismatched.

Arm's length principle in Article 9 of OECD Model Tax Convention: *"conditions are made of imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly"*.

ABOUT US

JLT Insurance Management provides leading corporations with Captive Consulting and Management services in Barbados, Bermuda, Guernsey, Malta, Singapore and the United States.

With annual written premiums and assets of over USD 2.3 billion and USD 4.9 billion respectively, we've a proven track record in helping clients choose a fitting domicile for their Captive Insurance Company by evaluating business goals and operational issues. In fact, over 30 of our current captives have transferred from other Captive Insurance managers. This is due to the active involvement of our highly experienced senior managers.

JLT Insurance Management forms part of the Jardine Lloyd Thompson Group of companies, one of the world's leading providers of insurance, reinsurance and employee benefits related advice, brokerage and associated services. We have offices in 40 countries and territories with some 10,000 employees. Supported by the JLT International Network, we service clients in 135 countries.

- Is the money moved between organisational group companies with the overall organisational support? If consolidated group revenue is over €750,000,000 there is a new country-by-country reporting requirement
- Is pricing internally done by your own measures or guidance from external sources?
- Are prices benchmarked reputably with accredited actuarial or accounting/tax resources?
- What is your transfer pricing policy?
- Is the allocation model reasonable and appropriate for the organisation's structure, risk, etc?

Any tax decisions should be made at organisational group level with support of a tax advisor. Where this affects the captive, it is worth being prepared with evidentiary support from the outset of the captive formation. In the long run, having documented support could protect your parent company from any further enquiry.

HOW WE HELP OUR CLIENTS

Speak to your captive manager about how to prepare your captive for BEPS. We can discuss your options and assist with preparing your solutions. We offer support at every stage in the the BEPS process:

- Review insurance programme
- Domicile review and selection
- Business plan and programme design
- Ongoing management and review

BEPS: A SUMMARY

Fifteen action points which need to be addressed by companies for their captive

1. Digital economy
2. Hybrids
3. CFC rules
4. Interest deductions
5. Harmful tax practices
6. Treaty abuse
7. Permanent establishment status

8.-10. Transfer Pricing
11. BEPS data analysis
12. Disclosure of aggressive tax planning
13. Transfer pricing documentation
14. Dispute resolution
15. Multilateral instrument

If you have any further questions or want to discuss your specific captive needs please contact:

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