

BEPS and its impact on captives

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Introducing the session, Charles Winter, Head of Risk Finance and COO for Aon Global Risk Consulting, described the OECD's objectives for the Base Erosion and Profit Shifting (BEPS) project which seeks to close gaps in international taxation for companies that allegedly implement tax planning strategies to avoid and/or reduce tax burden in their home country. With the

publication of the final OECD Action Plan in October 2015, businesses need to take action to proactively better align with the new requirements said Winter, adding: "BEPS is already looking at any potentially harmful tax practice where there is believed to be a dislocation between where value is generated and where profits are being recorded."

BEPS focus

The OECD has produced a BEPS Action Plan with 15 areas with some having more impact on captives than others. In particular, Winter pointed out the need to design effective Controlled Foreign Company rules, as well as the drive to improve transparency in reporting and documentation. Preventing the artificial avoidance of Permanent Establishment Status is also important said Winter: "This is very much saying that if the captive is going to be doing business in whatever domicile the captive is in, be that Ireland, Bermuda, Caymans or wherever else, it needs to be clear that the decision making is

happening in that domicile and not, for example, in the UK."

Three further areas of the OECD's action plan important for captives include the aligning of transfer pricing outcomes with value creation for movement of intangibles, and transfer of risks and/or allocation of capital. "It's saying we don't want money boxes that are overly capitalised for what they're doing," added Winter. In addition, the OECD's Action Plan prescribes the development of transfer pricing documentation to enhance transparency on global allocation of income.

Not business as usual

Drilling down into a couple of those areas Winter emphasised: "This isn't just transfer pricing business as usual. It's a much more holistic way of looking at the way a captive operates and generates value." Changes to guidelines for example ensure that incomes are not shifted to

'cash boxes' – capital-rich shell companies with few if any employees. Potential key consequences could be double taxation and non-recognition of premiums, as well as increased administration costs, increased documentation as well more fiscal uncertainty.

Assess the five dimensions

Given the implications of BEPS, Winter stressed that compliance with the new requirements should be addressed across five dimensions; the economic rationale of the risk transfer transaction; governance around decision making

and risk control; risk pricing and capitalisation appropriateness; substance of the captive activity and establishment; and documentation. Summing up the economic rationale Winter said: "Can you explain that if the captive was an unrelated party,

would you still do the same transaction with it? If this was any commercial insurer, would you let them charge those same premiums?"

On the substance area, Winter added: "It is an area that has attracted a lot of attention under BEPS

and it's really all about demonstrating that what is going on is going on in the captive's location. There has been a concern that the old out sourced model might not pass the substance test. As things have matured that has become less of an issue for many captive owners."

Being proportional

The principle of proportionality is key however when it comes to balancing the five dimensions said Winter. "It's about not just doing the things that are easy such as documentation and pricing work and then neglecting the things that are perhaps harder to do around governance and substance." Common points of attention needed across the five dimensions however include better documenting the economic rationale and ensuring the underwriting committee is beefed up and

there is a separation of duties under governance. "Substance does however remain the most difficult nut to crack," said Winter, "if it is deemed that more substance than can be provided through the outsourced model with good governance is required." Documentation was also probably the single area where most captives get a red flag added Winter: "They might be doing the right things but not documenting them in a way that can be reasonably demonstrated."

A focus on BT's Communicator captive

Tracey Skinner, Head of Risk & Insurance at BT then presented to the session on BT's own well established captive – Communicator. Having run for 27 years in the Isle of Man, with £50-55 million premium coming through each year, Skinner said: "The captive is of significant value to BT as an efficient way of risk financing and suits our business perfectly in the way that we are structured."

On BT's approach to BEPS, Skinner said they had taken a proactive approach with HMRC: "We put a joint team together and built a whole presentation pack around the five areas that we knew would be of interest and, over a couple of sessions, took HMRC through everything."

Specifically, on the area of economic rationale, Skinner emphasised that there is significant claims activity, adding: "This is a ground up coverage across all the areas in which it operates. We're not talking about there being an excess layer that is never touched with loads of premium coming through the programme."

From a governance perspective Skinner said: "There is an independent board, which I sit on, but it's very clear when I'm acting as a board member and when I'm acting as my day job. We have regular meetings on the island and we have a separate claims and underwriting committee which I do not sit on. We do have separate broker contracts in respect of the main placement of the layers in reinsurance which sit above the captive and the advice and support that the captive gets on its pricing is via a different source."

Skinner added: "Prices are benchmarked with the market on a regular basis. The captive is there to break even so my expectation as an insurance manager is to get a slightly better deal than I'm getting on the open market because of that break even situation."

On the substance issue, Skinner said it was probably the captive's weakest point because BT doesn't own Manx Telecom and has no other business in the Isle of Man. Skinner added that this is countered by the strong governance that the captive is able to demonstrate and by registering to pay UK tax on UK earnings.

Is BEPS the death of the captive?

Wrapping up the session, Charles Winter, referred to a question asked two years ago as to whether BEPS will be the next thing to cause the death of captives. Winter responded by saying: “BEPS is not the death of captives, it’s just another evolution. I think there is a position where captives are no longer the default answer to saying I want to retain risk, I’ll have to put it in a captive. Mature captives are writing less of certain classes of business and maybe that question of looking at a captive versus

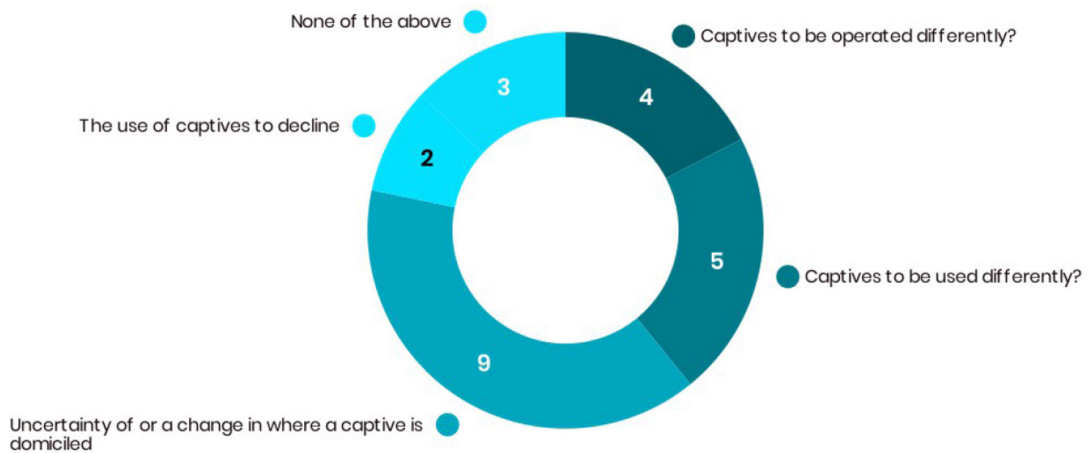
the next best alternative is taking up more time in feasibility studies and slowing the formation [of new captives].”

While there are tensions in domicile selection, Winter added: “Formations have slowed, but the overall trend is for growth in premiums. Mature captives are continuing to be used both for core business and sometimes some of the innovative other areas.”

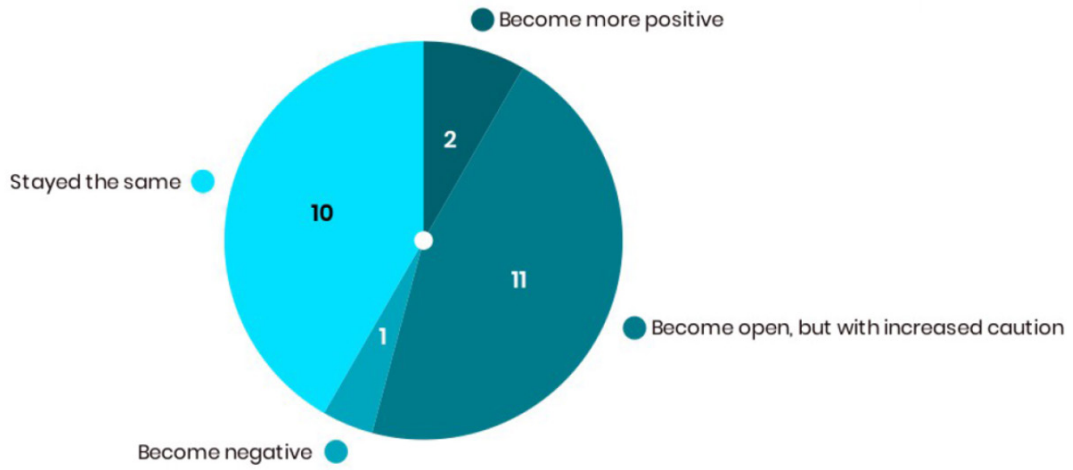
Airmic Survey

We asked Airmic delegates who manage captives the following:

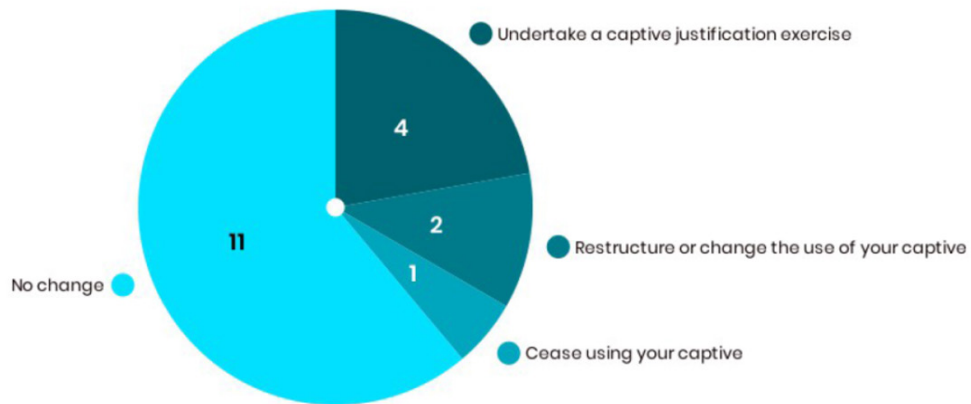
In your opinion, has BEPS caused



Following BEPS has your view on captives



For those with a captive, has BEPS caused you to



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