Global FS view on BEPS – latest developments for insurers

Event Date: Wednesday 21 October

Event Time: 9am EDT / 3pm CET

Notice

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Agenda

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Notes on CPE and polling questions

Continuing Professional Education (CPE) Credits

North America

- We require that participants are registered, logged in and take part in at least 4 of the 5 polling questions and participate in at least 50 of the 60 minutes to qualify for CPE credits for today's webcast.

Outside North America

- We encourage you to participate in the questions, as you may be eligible for continuing education credits in your local jurisdiction.

Polling Questions

- The first question will appear at the end of the first section, and the remaining questions will appear as we proceed through the presentation.
- As mentioned, in order to receive the CPE credit, we require that those participants take part in at least 4 of the 5 polling questions and participate in at least 50 of the 60 minutes to qualify for CPE credits for today's webcast.

Questions

- You may submit questions in the 'Ask a question' button on the left. We will answer as many questions as we can during Q&A. If we are unable to answer your question, someone from KPMG may reply via phone or email.
- For technical issues, please use the Question Mark button in the upper-right hand corner of the media player.

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- When the webcast is over, the webcast player will automatically refresh to display an exit survey. Feel free to complete the survey, as your comments are very valuable to us.

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Polling question 1

Now that the final BEPS recommendations have been released by the OECD, how are you reacting to it?

A) Very actively	Reviewing BEPS developments and taking action within the group (e.g. structural change, changes to transfer pricing)
B) Somewhat actively	reviewing BEPS Action Plan and considering impacts on my organization
C) Passively	monitoring developments only

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Where are we now?

John Neighbour
KPMG's Head of Global Financial Services Transfer Pricing
KPMG in the UK

BEPS: October 2015 Deliverables

- **The BEPS project in October 2015**
  - Agreement on how to tackle base erosion and profit shifting
  - Wide participation around the globe
  - Significant change to the international tax landscape
  - OECD estimates global revenue losses from BEPS of between USD 100 billion and USD 240 billion annually
  - EU action against BEPS activity
  - Not over yet – now focused on implementation

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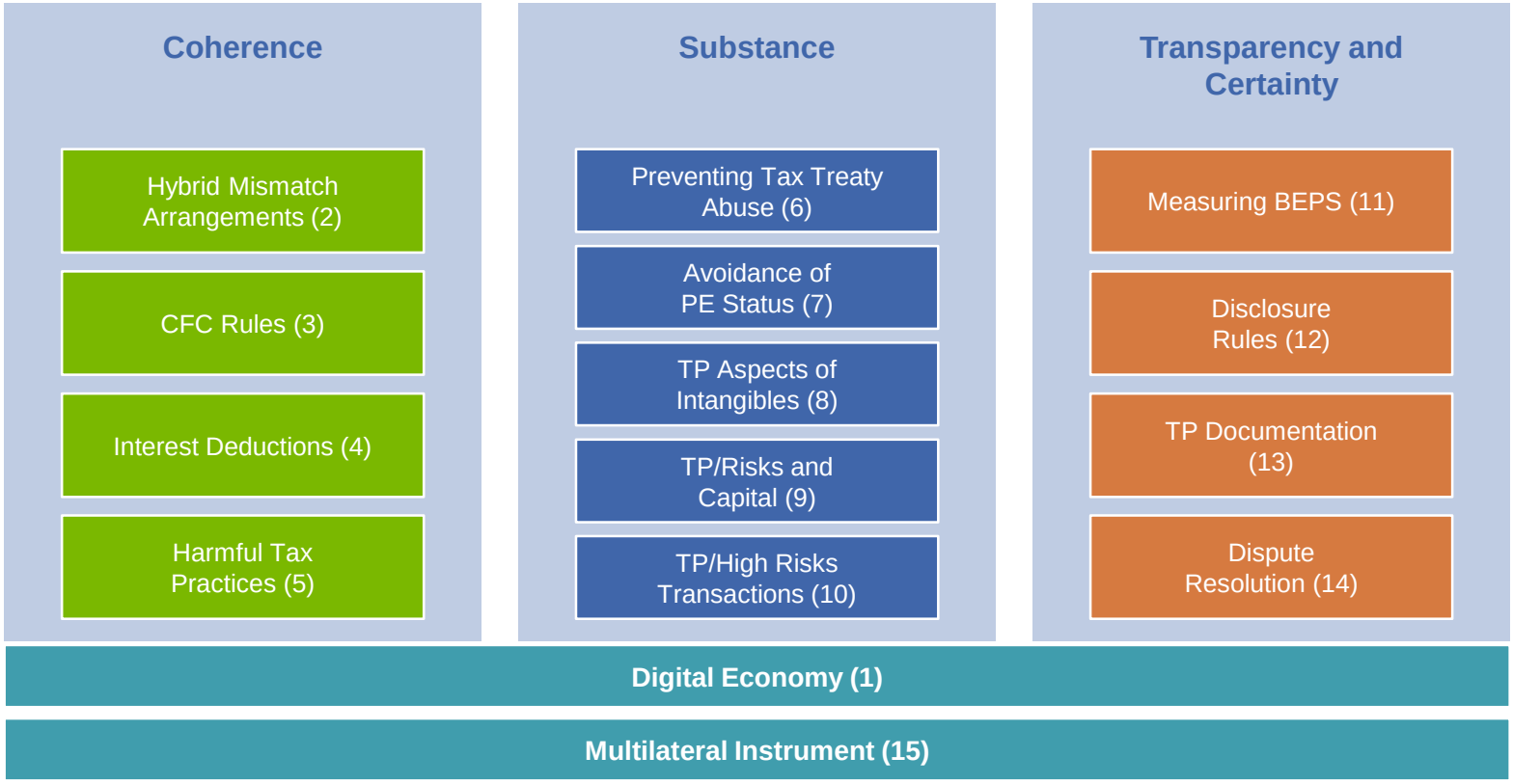
15 Actions around 3 Main Pillars



Source: OECD, BEPS Webcast - Launch of the 2015 Final Reports, 5 October 2015

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October 2015 Deliverables: how changes have been agreed

- **Minimum standards**

  - IP regimes (5); Treaty abuse (6); Permanent Establishments (7); Dispute Resolution (14)

- **International standards for tax treaties and transfer pricing**

  - IP and Transfer Pricing, and Documentation (8-10, 13)

- **Recommendation and best practices**

  - Hybrids (2); CFC rules (3); Interest deductions (4); Disclosure rules (12)

- **Areas which require further work**

  - Digital economy (1); BEPS data analysis (11)

- **Wholesale implantation**

  - Multilateral instrument (15) supports implementation in respect of Hybrids (2), Treaty abuse (6), PE (7) and Dispute resolution (14)

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Polling question 2

How do the Board and C-level management of your company perceive the significance and potential impact of the BEPS Action Plan?

A) Concerned	They have a high-level understanding and are engaged and interested in potential implications and actions they should consider
B) Aware	They understand it, and there is some dialogue about it, but they are not concerned
C) Passive	They are aware of the debate but are neither concerned nor engaged in regular dialogue about it
D) Not aware	They are not aware of the BEPS Action Plan
E) I do not know	I do not know

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Impact for insurers

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KPMG's Head of Global Insurance Tax
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Key points for Insurers – a reminder as to what is changing

Global view of value chain

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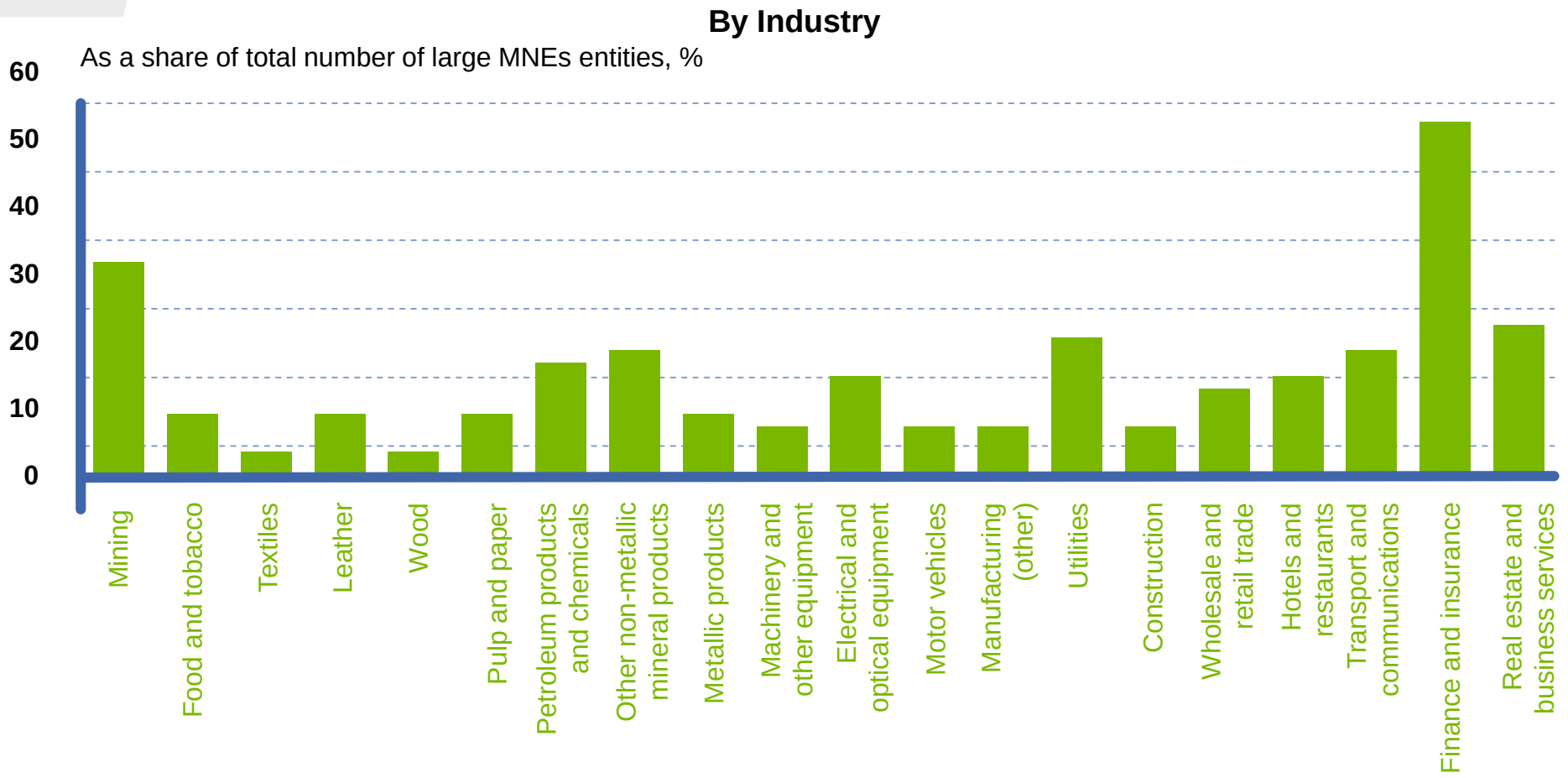
Measuring BEPS – Financial Services

Identified links to no-corporate-tax countries of entities in the sample



Source: OECD Action 11, Final Report, 2015

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Two Key Developments on "Dependent Agent" PEs

Conclusion of Contracts Test in Art 5(5) is now more broad

- A permanent establishment will arise where a person (other than an independent agent) is acting in the State on behalf of an enterprise and habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the foreign enterprise
- Location of signing of a contract may not be enough

Independent Agent Exclusion in Art 5(6) is narrower

- No PE arises if the agent carries on business as an independent agent – however;
  - A person who acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related will not be considered to be an independent agent
  - "Closely related" - if based on facts and circumstances there is common control, [in any case where more than 50% beneficial interest]
  - Agents not closely related may still be dependent agents
  - As before, an independent agent must act only in the ordinary course of that business (rather than in the course of the foreign enterprise's business)

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Other Key Developments on Fixed Place of Business PEs

Specific Exemption Activities in Art 5(4) are narrower

- List of "safe harbour" activities which can be carried out at fixed place of business is retained and includes collection of information
- However the activities must now be "Preparatory or Auxiliary", [unless both States agree to retain current Art 5(4), in which case they must include the new anti-fragmentation rule]

New Commentary on Meaning of "Preparatory or Auxiliary" ;

- "Preparatory" - carried on in contemplation of rather than in the carrying on of the essential and significant part of the activity of the enterprise as a whole – often carried on for a short period
- "Auxiliary" – carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole
- Insurance enterprise gathering information, such as statistics, on risks in a particular market is specifically cited as example of preparatory

Anti Fragmentation (new Art 5 (4.1)

- Anti avoidance to prevent avoidance of PE by separating/fragmenting activities so as to separately avail of safe harbour exemptions

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Specific Insurance Provision Deleted from final OECD Paper. Good news but ……..

- The OECD paper acknowledges that some States were concerned that insurers were able to write large scale business is a State without being taxed in that State
- The OECD view is that the general changes to the definition of PE have addressed “some of” the concerns
- OECD notes that various countries include a provision in local law and Treaties which deem Insurers to have a PE if they collect premiums or insure risks in the State through an agent (UN Model Treaty)
- OECD concluded that “it did not seem advisable” to insert this type of provision in the OECD Model Treaty
- However, UN Model Treaty rules still more prevalent in Middle East and developing world, and OECD acknowledges that whether or not to include will depend on factual and legal situation in both States

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Issues for Insurers

- Track where employees playing the principal role leading to the conclusion of contracts are located when they do this
- Could a “Rep Office” be a PE under new fixed place of business rules and new commentary on meaning of “auxiliary”?
- Are related parties in the sales process independent? Are they playing a principal role leading to the conclusion of contracts that are formally concluded without material modification by the foreign enterprise?
- Are there closely related foreign agents who have been “given the pen” to put clients on risk, even if within certain parameters?
- Are the products standardised? Products which do not need any detailed underwriting or manual intervention may need careful review
- If new PEs are created (whether based on fixed place of business or dependant agent) how will profit be attributed?

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BEPS Action Items most relevant to Insurance

Other Actions that have the potential to affect insurers

- **Action 6 – Treaty Benefits**
  - Changes could have an impact on withholding taxes arising on some premium payments and investment income
  - Proposed measures include:
    - Clear statement not to avoid tax
    - Limiting benefits via:
      - Combine simplified LOB with PPT, or
      - Details LOB with anti-conduit measures, or
      - PPT
  - Intention is to implement measure into existing tax treaties through Multilateral Instrument
  - Contracting States to decide how “CIV” should be defined
  - If CIV qualification is to be conditional then implementation of the TRACE project is important
  - No immediate conclusions on Non-CIVs. Further work to be done in 2016
  - Pension funds to be provided with resident status

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BEPS Action Items most relevant to Insurance

Other Actions that have the potential to affect insurers

- **Action 4 – Interest Deductions**
  - Recommended best practice of cap of net interest expense of 10% to 30% of EBITDA, with additional deduction if group ratio higher
  - Could impact funding structures for unregulated vehicles within insurance groups
  - Further proposals will be presented in 2016 for regulated banks and insurance companies

- **Action 14 – Dispute Resolution**
  - Ensure that treaty obligations related to the mutual agreement procedure (MAP) are fully implemented in good faith and that MAP cases are resolved in a timely manner
  - Ensure the implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes
  - Ensure that taxpayers can access the MAP, when eligible

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BEPS Action Items most relevant to Insurance

Other Actions that have the potential to affect insurers

- **Action 2 – Hybrid Mismatches**
  - Complex area (450 pages from OECD on suggested common approach) - which could have an impact, depending on use of financial instruments and arbitrage structures, irrespective of whether tax planning or not
  - Open to countries to apply or not apply the rules to intra-group hybrid regulatory capital
  - Treaties may include rules to deny undue treaty benefits for hybrid instruments and entities
  - Some countries have already implemented measures

- **Action 3 – CFCs**
  - Sets out best practice building blocks for effective CFC regime
  - Could affect the location of some insurance vehicles, including captives

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Polling question 3

Do you think the BEPS initiative will ultimately increase your organization's Effective Tax Rate?

A) Yes

B) No

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Transfer Pricing

Robin Saunders
Senior Manager, Global Transfer Pricing Services
KPMG in the UK

Key Highlights from the Final Report on Actions 8-10

On October 5, 2015, the OECD released final guidance under Actions 8, 9, and 10 in one report. The guidance takes the form of amendments to various chapters of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines).

- **Chapter I**
  - addresses the capacity to assume and control risk, the relationship between contractual arrangements and conduct, as well as the return for low functioning or "cash box" companies.
  - sets out the circumstances in which transactions that lack commercial rationality can be *disregarded*.
- **Chapter II**
  - additions to Chapter II to address intra-group commodity transactions.
  - addresses applicable methods (generally the Comparable Uncontrolled Price ("CUP") method) and the application of the methods (e.g. economically relevant characteristics) to commodity transactions.
- **Chapter VI**
  - clarifies the definition of intangibles and HTVI, discusses ownership of intangibles and transactions involving development, enhancement, maintenance, protection and exploitation ("DEPME") of intangibles.
- **Chapter VII**
  - provides guidance regarding intra-group services transactions and an elective simplified method or safe harbor for low value-adding services.
- **Chapter VIII**
  - an entirely new version of Chapter VIII - defines CCAs, addresses the value of contributions to CCAs and addresses the substance of CCA participants.

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The guidance in final report focuses on a rewrite of Chapter 1 Section D of the OECD Transfer Pricing Guidelines

- Actual business transactions supersede contractual arrangements
- Contractual allocations are respected when supported by actual decision making
  - To assume a risk for transfer pricing purposes, an entity needs to 1) control the risk and 2) have the financial capacity to assume the risk
  - 6 step process to analyze risk in a controlled transaction
    - Clear identification of risks
    - Risk management versus "assumption of risk"
    - Financial capacity to assume the risk
- Return to capital
  - Does the capital provider exercise control over investment risks?
- "Exceptional circumstances of commercial irrationality" may result in disregarding of transactions

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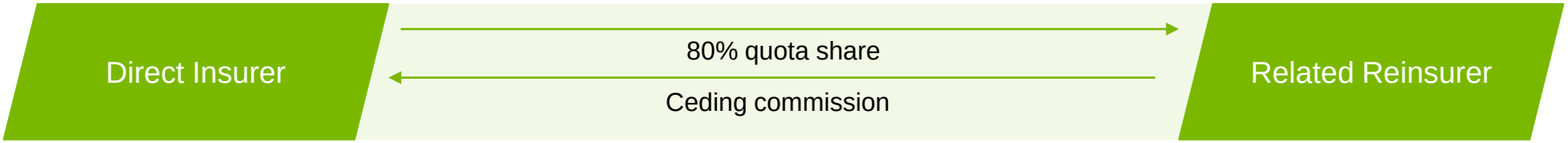
Control of Risk Example - reinsurance



▪ Client relationship ▪ Underwriting decisions ▪ Issuing the policy ▪ Claims handling ▪ Investment management ▪ Capital management ▪ Outward reinsurance to third parties	▪ Functions	▪ Writes 80% quota share intra-group ▪ Outsources routine functions to Direct Insurer or third parties ▪ Relies on Direct Insurer to notify claims
▪ 20% underwriting profit ▪ Ceding commission ▪ Investment income	▪ Remuneration	▪ 80% underwriting profit, less ceding commission ▪ Investment income

- Direct Insurer performs all 'people functions' in the value chain in respect of the policies it writes with third parties.
- Related Reinsurer assumes 80% of the insurance risk under a quota share and pays an arm's length ceding commission.
  It has its own Board, with sufficient insurance expertise.
- Related reinsurer has the **financial** capacity to assume the insurance risk.
- Does related reinsurer have **control** of insurance risk?
- What is the return to related reinsurer's capital?
- If Direct Insurer has reduced its own capital to set up Related Reinsurer, which has no other business, don't recognize?

Source: KPMG International, 2015

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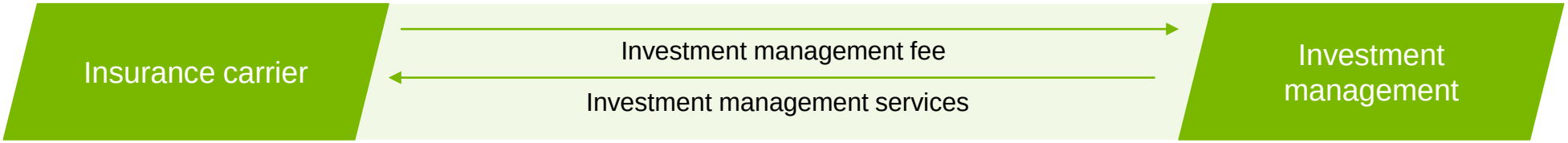
Control of Risk Example – reward for managing risk



▪ Client relationship ▪ Underwriting decisions, issuing the policy	▪ Functions	▪ ALM ▪ Investment risk ▪ Input into capital management ▪ Input into reserving (discount rates for life and pensions business)
▪ Underwriting profit and investment income	▪ Remuneration	▪ Investment management fee

- Central investment management team manages investment risk and interest rate risk on behalf of local regulated insurance carriers.
- Investment returns are a key component of insurance companies' profits. Where loss ratios are close to 100%, it may be the main source of profits. For long-tail business, interest rate risk and investment risk are two of the main risks to be managed.
- Return to investment team is generally set to cover any third-party investment management fees and leave a small margin over internal costs.
- Under proposed approach to risk and return tax authorities may argue for a higher return to investment function or make them part of profit split
- A similar analysis could apply to other risk-related functions such as actuarial and capital modelling.

Source: KPMG International, 2015

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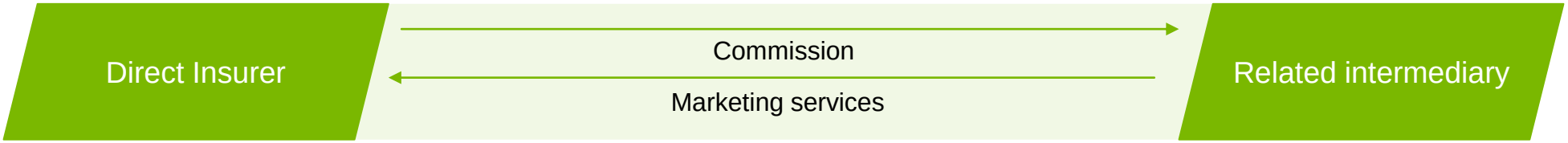
Dependent agent permanent establishment example



▪ Underwriting decisions ▪ Issuing the policy ▪ Claims handling ▪ Investment management ▪ Capital management	▪ Functions	▪ Client relationship ▪ Marketing
▪ Underwriting profit ▪ Investment income	▪ Remuneration	▪ Commission

- Related intermediary markets standardized products to individuals in its territory.
- It only acts for Direct Insurer.
- Suppose Related Intermediary ***"plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification"*** *(new para 5 of Article 6)* leading to PE of Direct Insurer
- Direct Insurer performs KERT of assuming insurance risk, ***"typically falling within the category of underwriting activities"*** *(2008 PE Report, Part IV para 94)*
- Direct Insurer is attributed premiums, risk and capital, investment income
- DAPE is attributed arm's length commission and pays this to Related Intermediary
- Will 2016 review of PE Report move KERT definition closer to PE new threshold?

Source: KPMG International, 2015

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Additions to Chapter II and Chapter VI

Chapter II:

The guidance in final report provides new guidance on commodity transactions

- CUP is generally the preferred method
- Practical guidance on characteristics to adjust for
- Tax authorities can impute a transaction date if no reliable evidence exists

Transactional Profit Split and Financial Transactions

- Lack of comparables and one sided methodologies
- Practical aspects of implementing a profit split
- More work to be done

Chapter VI:

New version of Chapter VI building on the September 2014 report

- Legal ownership itself does not determine the right to return
- Economic return for Development, Enhancement, Maintenance, Protection and Exploitation (DEMPE) activities
- Need to “exercise control” over risks and have the financial capacity to assume risks
  - Provision of funding receives a risk-adjusted return
- Valuation approaches on HTVI
  - Use of *ex post* evidence to analyze *ex ante* arrangements

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Changes to Chapter VII and Chapter VIII

Final Report provides a rewrite of Chapter VII and Chapter VIII

Key Highlights on Chapter VII – Low Value Added Services

- Largely consistent with the Discussion Draft of November 2014
- Low Value Added Services are support services – not core or not creating an intangible: In essence, back office services
- An Elective Method for establishing arm's length charges
  - General allocation keys
  - Simplified benefits test
  - 5% Markup
- Implementation to be phased

Key Highlights on Chapter VIII – Cost Contribution Agreements

- Expectation of mutual benefit is a pre-requisite
- Control is a prerequisite – need to make the decision to participate and stay in the CCA
- Value of contributions to CCA need to be aligned with reasonably anticipated benefits

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Action 13 – Three tiered standardized approach

Final report is consistent with the report issued on September 16, 2014, focusing on a three-tiered approach for documentation:

Master file

- Objective: Risk Assessment
- Approach: Provides an overview of the multinational group and business

Local file

- Objective: Appropriate considerations in setting transfer prices
- Approach: Provides additional detail on the operations and transactions relevant to that jurisdiction

CbC report

- Objective: Prioritize Audit Issues
- Approach: Provides summary data by jurisdiction including revenue, income, taxes, and indicators of economic activity

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CbC Template Implementation

Which MNEs are required to file a CbC report

- MNEs with consolidated group revenue in the preceding fiscal year of 750 million Euros or more

Timing of CbC report

- File for the fiscal years beginning on or after January 1, 2016
- MNEs will be allowed one year from the fiscal year end to file the CbC report

Where filed and mechanisms for exchange

- File CbC report in the country of the ultimate parent of the MNE
- That country will exchange this information on an automatic basis with jurisdictions in which the MNE operates and that meet the necessary conditions described in guidance.
- An XML Schema and User Guide to be developed by end of 2015 to accommodate electronic exchange of CbC reports

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CbC Reporting - Potential Issues and Challenges

It is NEW

- Separate from transfer pricing documentation and not previously required
- Tax authorities will have right to obtain data on profits in all countries in which the Multinational Entity (MNE) operates

Beyond Transfer Pricing (TP) information

- A lot of this information is not information typically presented in existing transfer pricing studies
- Will require concerted effort by MNEs to determine process, ownership, and technology to obtain information

Risk assessment tool

- Intended to be used by OECD as a risk-assessment tool
- Used by tax administrations in evaluating other BEPS related risks and potentially economic and statistical analysis

Will affect many MNEs

- Countries are adopting their domestic laws requiring any MNEs with entities where adopted to prepare regardless of headquarter location

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Polling question 4

Would you be concerned if your Country-by-Country Report was to be made public?

A) Yes

B) No

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Implementation

Michael Plowgian
Principal, Washington National Tax
KPMG in the US

Further Work

Further Work On:

- Action 1 – Re-evaluation after other follow-up work has been done; report to be produced by 2020
- Action 4 – Technical aspects of group wide ratio rule (e.g., calculation of third-party interest expense, definition of group EBITDA); special rules for banks and insurers; transfer pricing of financial transactions (2016 and 2017)
- Action 5 – Framework to engage non-OECD countries; revisions to criteria for harmful regimes; ongoing monitoring
- Action 6 – Review of LOB in light of U.S. changes; treaty entitlement of recognized pension funds, REITs, other non-CIV funds (2016)
- Action 7 – Profit attribution to PEs (2016)
- Actions 8 – 10 – Profit splits
- Action 14 – Framework to monitor compliance with minimum standard; mandatory binding arbitration provision
- Action 15 – To be delivered December 2016
- Monitoring of country implementation

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Further Work (cont'd)

Work will be done as a continuation of the BEPS Project

- Includes G20 countries on an equal footing
- Developing countries to be included
- Treaty abuse, profit attribution, transfer pricing of financial transactions during 2017.

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US Position

Three categories of action

- Can be implemented by Treasury through regulatory authority
  - Actions 8 – 10, 13
- Cannot be implemented without legislation
  - Actions 2, 3, 4, 5
- Implementation by treaty (Treasury negotiates, Senate ratifies)
  - Actions 6, 7, 14, 15

Increased source country taxation and foreign tax credits

- Potential impact on US tax reform?
- CFC rules, interest deductibility, hybrids

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Polling question 5

Would you like to be contacted by a KPMG professional to discuss the impacts of BEPS on your organization?

A) Yes

B) No

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Q&A

Thank you! Please contact us if you have any questions

1

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