Polling Question 1: Which of the following best describes what you do/for whom you work?

1. Captive Owner/Risk Manager
2. Captive Manager
3. Regulator
4. Auditor/Actuary/Attorney
5. Other
Background

• Who are the OECD
  o Originally formed in 1948 as the Organization for European Economic Cooperation to run the Marshall Plan to restore a continent ravaged by war.
  o Later joined by Canada and USA.
  o 1961 became the Organization for Economic Cooperation and Development.

• What is their mission
  o Promote policies that will improve the economic and social well being of people around the world.
  o Better Policies for Better Lives
I. Why the OECD Targeted Base Erosion and Profit Shifting (BEPS)
Why the Emphasis on Base Erosion and Profit Shifting (BEPS)?

- OECD member countries have been unable to regulate and more specifically tax Multi-National Enterprises (MNE’s) to fund their programs.
- Introduced concept of abusive tax avoidance to embarrass MNE’s to pay their ‘fair share’ of Taxes (Moral Obligation).
- OECD saw Transfer pricing as a ‘soft’ target which would substantially increase member countries’ taxable revenues.
- Lack of harmonized regulations hurting them in their attempt to raise more taxes.
Why the Emphasis on BEPS?
(Continued)

• G-20 Leaders summit in November 2013 OECD obtained a mandate to tackle BEPS.
• Instructed to produce an Action Plan which was published in February 2013 and was approved by G-20 leaders in September of the same year.
• G-20 and OECD successfully construe ‘tax avoidance’ as ‘tax evasion’ and introduce ‘moral obligation’ philosophy.
• Report listed 5 other ‘Pressure Areas’ and included Captives as a ‘vehicle for abuse’.
• MNE’s using Captives shifting profits to low or no income tax countries.
BEPS Report (Continued)

Report suggests Captives are vehicles of abuse

• CICA and ECIROA Responded saying in part:
  o 6000 Captives worldwide operating in the same way as traditional insurance companies.
  o Captives are an integral part of Enterprise Risk Management.
  o Captives are the only tool available to MNE’s to manage otherwise uninsured exposures.
  o Captives allow MNE’s to enter the re-insurance market.
  o Captives allow their parents/owners to insure risks not available in the traditional market.
  o Captives are responsible for the greater availability of reinsurance as their need resulted in the incorporation of new highly capitalized Reinsurance Companies.
Polling Question 2: Do you think your captive will be affected by the OECD BEPS Project?

1. No
2. Yes, at some point in the distant future
3. Yes, within 2 years
BEPS Action Plan

Identified 15 Actions organized around three main pillars:

• The *coherence* of corporate tax at the international level
• A realignment of taxation and *substance*
• *Transparency*, coupled with certainty and predictability
The Action Plans

1. Address the Tax Challenges of the Digital Economy
2. Neutralize the Effects of Hybrid Mismatch Arrangements
3. Strengthen Controlled Foreign Companies Rules
4. Limit Base Erosion via Interest Deductions and Other Financial Payments
5. Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance
6. Prevent Treaty Abuse
7. Prevent the Artificial Avoidance of PE Status Instrument
8. Assure that Transfer Pricing Outcomes are in Line With Value Creation / Intangibles
Action Plans (continued)

9. Assure that Transfer Pricing Outcomes are in Line With Value Creation / Risks and Capital

10. Assure that Transfer Pricing Outcomes are in Line With Value Creation / Other High-Risk Transactions

11. Establish Methodologies to Collect and Analyze Data on BEPS and the Actions to Address It

12. Require Taxpayers to Disclose Their Aggressive Tax Planning Arrangements

13. Re-examine Transfer Pricing Documentation

14. Make Dispute Resolution Mechanisms More Effective

15. Develop a Multilateral Instrument
Polling Question 3: Do you think the OECD’s goal of Global Tax harmony will ever be achieved?

1. Yes
2. No
Summary

• OECD’s Purpose
  o Prevent MNE’s from using what they perceive as tax havens.
  o To align profits to where activity takes place.
  o To introduce a Multinational Instrument to implement their plans.

• OECD’s Beliefs
  o These problems cannot be solved by individual countries.
  o The worst thing that can happen is for individual countries to take unilateral actions.

• OECD’s Success?
  o Turning point in the history of Cooperation between countries on matters of taxation. An unprecedented scale of collaboration.
  o Significant consultation with a broad spectrum of society.
II. The History of Captives and Their Primary Role as Risk Management Tools
Polling Question 4 (Two Parts):
Where is your captive managed?
1. Onshore.
2. Offshore.

How is your Captive managed?
1. Management Company.
2. Own staff employed directly by the Captive.
3. Within Home Office Insurance Division.
History of Captives

• See slides 63-67 for a brief chronology of the History of Captives.
• Captive Insurance was developed to meet business needs not addressed by the Traditional Insurance Market.
• Captive Insurance is a Viable Economic Solution to Commercial Market Challenges.
• Risk Management Remains the Primary benefit of Captives.
• Captive formations continue to grow.
Summary

• It is important to understand why a particular domicile was chosen to form your Captive.

• Possible future concern is the OECD’s desire to relate income and profits to activity and decision making. (Substance over Form).
III. Meeting OECD Action Plan Requirements for Coherence
OECD Action Plan 4

- Targets “excessive” interest and other financial payments
  - Premiums paid to captives fall into this category

- Need to show that premiums are determined in accordance with accepted insurance practices
  - e.g., Arm’s Length Principle

- Detailed financial analysis needed for risks that are difficult or impossible to insure
Arm’s Length Principle

• Intercompany transactions
  o Must conform to the level of transactions between unrelated parties

• Captive premiums
  o Sufficient premium for coverage; not over or underpaying

• Arm’s Length Principle addressed by Section 482 Regulations
  o Premiums at tax parity with third party transactions

• Arm’s Length Principle addressed by OECD
  o The international standard for determining transfer prices
Transfer Pricing – Sources for Methodology

- Local country’s transfer pricing regulations
- OECD guidelines
- Local tax authorities
- Case law
Transfer Pricing – Regulations

• Support for Transfer Pricing Method
  o Based on specific facts and circumstances of the related party transaction
  o Comparable data (e.g., comparable uncontrolled prices, gross profit margins, and cost markups)

• Captives
  o Methodology must identify appropriateness of pricing based on amount of retained risk and capital
Comparative Transactions

• Advantages of internal support
  o More likely to “fit” affiliated transaction
  o Information is more likely to exist and be readily available
  o A wider base of support is needed if external sources are used

• External sources
  o Government
  o Commercial databases
  o Industry associations
  o Employee knowledge
  o People within the captive insurance industry / trade associations
Transfer pricing regulations in the U.S. and among OECD member countries require captive owners to demonstrate their insurance premiums were determined in line with the arm’s length standard, and their transactions are consistent with third party activities within the captive insurance industry.
IV. Meeting OECD Action Plan Requirements for Substance
OECD Action Plans 8, 9 and 10

• Ensure profits in line with economic substance of activities
  o Focus on where important people functions are performed

• Ensure capital allocated is in line with risk
  o Captive premium paid should be in line with contractually assumed risk

• Prevent abusive transactions
Economic Substance

• Addresses transactions lacking economic purpose
  o Transactions entered into only to avoid taxes

• Two-Tiered Test
  o Must impact taxpayer’s economic position
  o Needs to have a legitimate non-tax business purpose

• OECD’s Third Criterion
  o Management and control of transaction
Polling Question 5: Have you ever had discussions with senior MNE management about the two tiered test (transaction impacts economic position, and has legitimate non-tax business purpose)? Is this worth revisiting and documenting?

1. Yes and it is worth revisiting and documenting.
2. Yes and it isn’t worth revisiting and documenting.
3. No but it is worth discussing and documenting.
4. No and it isn’t worth discussing or documenting.
Enterprise Risk Management ("ERM")

• Objective – Manage combined impact of all risks as an interrelated portfolio

•Advantages
  o Encompasses all areas of organizational exposure to risk
  o Provides a structured process for management of all risks
  o Recognizes that organizational risks are interrelated
  o Embeds risk management as a component in all critical decisions
Captives’ Role in ERM

- Guards against disruptive scenarios
  - Protects the continuity of a company’s business plan

- Addresses issues of availability and affordability

- Efficient and effective at addressing risk management needs
Captives’ Role in Risk Distribution

• Risk distribution – an accepted prudent business practice

• Captives – a legitimate means for shifting insurance risk
  o Must meet regulatory, actuarial, accounting, and capital requirements
  o Premiums determined by arm’s length principle
  o Involves real economic transfer of risk
  o Satisfy requirements of economic substance
  o Managed by qualified personnel (MBAs, CPCUs, CPAs, CRMs, etc.)
OECD Challenges to Captives

• Artificial transfer of income
  o In reality, captives have a legitimate business purpose

• Limited non-tax benefits

• Heavy dependence on personnel elsewhere in the group
Polling Question 6: What effect will the OECD’s pursuit of substance over form have on the way you manage and staff your captive?

1. None.
2. Very little.
3. We will consider staffing our captive with our own employees.
4. We will consider moving our insurance division to the Captive’s domicile.
Summary

The OECD’s BEPS Report and Action Plans infer that captives are used to artificially transfer income from MNEs in a taxable jurisdiction. In reality, the formation of captives is driven by corporate risk management strategies that have substantial business purpose and are managed by key personnel who understand all aspects of each MNE’s risks.

In light of the OECD’s demand for senior and experienced decision makers within the captive itself, it is likely the value added in the captive domicile compared to the value added by personnel located onshore, for example in the head office, may be evaluated. Where it appears non-tax benefits to the group from the transfer of risk are limited, or where the captive is too heavily dependent on personnel elsewhere in the group for underwriting, policy documentation, and pricing, challenges can be expected.
V. Meeting the OECD Action Plan Requirements for Transparency
Meeting the Action Plan Requirement for Transparency

Demand for Tax Transparency

• Society’s push for ‘fairness and equality’.
• 2008 Down turn fueled the fire.
• Global regulation initiative.
• Clear and accurate reporting of corporate tax transactions.

Regulatory Controls (How they affect Captives)

• Anti-Money Laundering and Know Your Client Documentation.
• Application Process - more information required.
• Time consuming but substantiates Captive’s legitimacy.
• Ongoing Regulatory Monitoring.
Financial Reporting

• Certified audited financial statements
• Generally describe the following:
  o Organization, ownership & related parties
  o Accounting framework and policies
  o Types of risk underwritten and loss activity
  o Investments
  o Surplus and capital transactions
  o Tax positions
• Provide a good picture of profit drivers
Common Profit Drivers

• Premiums
  o Generally supported by actuary and/or market quotes
  o Reviewed during audit testing

• Investments
  o Independent custodians & advisors
  o Confirmation of holdings & testing of valuation
  o Regulatory reporting requirements
  o Restrictions for risk retention groups
  o What about loan-backs?
Common Profit Drivers

- Ceding commissions
  - Formal contracts by qualified professionals
  - Benchmark terms & conditions to similar contracts in market
Polling Question 7: Which of the following transactions are most susceptible to profit shifting manipulation?

1. Premiums
2. Investments
3. Reinsurance
4. Loan-backs
5. Other
Tax Disclosures

• Jurisdictions where captive is subject to taxation
• Effective rates - combined & for various jurisdictions
• Detail of significant tax drivers
• Deferred tax drivers
• Entities included in any consolidated filings
• Method for allocating tax liability among consolidated group
• Uncertain tax positions
Financial Reporting

- Employ of third party professionals – provide analysis & documentation
- Audit reviews documentation & design effectiveness of internal controls (audit generally does not opine on operating effectiveness)
Financial Reporting

• Documentation that supports audit test work provides good basis for providing clarity to transactions – although not always sufficient to satisfy the contemporaneous documentation requirements for different taxing authorities around the world

• Formalizing & augmenting this documentation to cover OECD & local country guidelines will ensure captive compliance
Transfer Pricing

• Profit allocation method used to apply a MNE’s net earnings (or losses) to attributed jurisdictions
• Involves terms & pricing which related parties sell goods or services to each other
• Roughly 40 countries have adopted rules
• Documentation crucial to prove arms-length policy
Transfer Pricing

• Study should include, but not be limited to:
  o Industry overview & analysis of economic & legal factors
  o Organizational structure & related parties
  o Strategy
  o Functional analysis
  o Description of goods & services
  o Description of comparable uncontrolled transactions & how comparability was evaluated
  o Forecasts & projections relied upon in selecting method
  o Explanation of selected method compared to alternatives
  o Benchmark study of comparable companies/transactions
Regulatory Compliance Reporting

• List of regulatory documents
  o Annual report & audited financial statements
  o Feasibility study
  o Trial balance
  o Claim history
  o Actuarial opinions
  o Insurance policies
  o Transfer pricing study or advanced pricing agreements
  o Board minutes
Tax Compliance Reporting

• List of tax compliance filings
  o Basic federal tax return
  o Uncertain tax positions
  o IRS forms
    • 5471 & 5472 to disclose nature & amount of certain dealings with non-US entities
    • 8886 to disclose reportable/listed tax avoidance transactions
  o Protective filings (give insight)
  o Foreign Account Tax Compliance Act (FATCA)
  o Foreign Bank & Financial Accounts (FBAR)
  o State filings & income apportionment
Summary

• The information captives are required to disclose in regulatory filings upon formation and during their operation combined with their financial and tax compliance reporting is substantial. Significant and consistent documentation standards and practices could assist the tax administrator to more efficiently assess tax compliance and perhaps alleviate some of the potential misunderstanding of the captive’s operations. Lastly, compliance with OECD’s Action Plan on documentation will help alleviate misunderstandings related to the captive industry.
VI. Meeting OECD Action Plan Requirements for Tax Practices
Polling Question 8: Which of the following is most important to consider when establishing a captive?

1. Control of losses
2. Taxes
3. Better premium rates
4. Access to reinsurance
5. Other
US Tax Definition of Insurance

• Internal Revenue Code (IRC) § 816(a) and 831(c)
• Treasury Regulation § 1.801-3(a)(1)
• A company whose primary and predominant business activity (more than half) during a tax year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies
Three Prong Framework

• Presence of insurance risk
  o Result of an unanticipated event causing economic loss
  o Risk must represent 50% or more of entities revenue
  o Risk cannot be business or investment risk
Three Prong Framework

- Common accepted notions of insurance
  - Based largely on specific facts & circumstances, considering the following:
    - Organizational structure
    - Substance of transactions
    - Nature of operations
    - Regulatory status in domicile
    - Adequacy of capital for risk assumed
    - Existence of valid binding contracts with rates established at arm’s-length
Three Prong Framework

• Risk shifting and risk distribution
  o Contract must shift some or all of risk for economic loss from the policyholder to the insurer
  o Risk should be distributed widely enough among unrelated parties so that the statistical phenomenon known as the law of large numbers can work
  o Must consider entities at a taxpayer level (brother-sister related parties)
  o Can fail risk shifting if:
    • Insufficient capital,
    • Excessive guarantees or loan-backs, or
    • Indemnified by parent or any other entities
Insurance Position

• Insurance for regulatory domicile purpose doesn’t mean federal criteria satisfied
• General criteria based on historical guidance issued by the IRS & tax courts – position is based predominately on specific facts & circumstances
• Continue to be subject to controversy & litigation due to related party nature & unique risks insured
• Criteria must be determined annually
US Tax Efficiencies

- Captive can deduct estimate of unpaid losses
- Insured can deduct the premiums
- Captive can invest up-front tax savings
- Small company election under IRC § 831(b)
- State income taxes
Foreign Considerations

• Controlled Foreign Corporation (CFC) rules
  o IRC § 951-965 often referred to as subpart F
  o Foreign captive that is more than 25% owned by U.S.
    shareholders
  o Criteria to define a U.S. shareholder
• IRC § 953(d) election to be treated as U.S. taxpayer
• IRC § 4371 related to Federal Excise Tax (FET)
Potential Tax Abuses

- Tax abuse opportunities are greater for a captive due to related party relationships & subjective nature of insured risks
  - Manipulation of premium pricing
  - Aggressive estimates for unpaid loss accruals
  - Excessive loan-backs to parent or affiliated entities
  - Manipulation of premium allocation among corporate structure to ensure sufficient risk distribution
Potential Tax Abuses

• Small company election – unreasonable pricing of risks to maximize tax savings
  o Must meet same federal insurance company criteria
  o Due to size of middle market businesses, very few are MNE’s or non-US domiciled
  o Limited impact on OECD action plan
Mitigating Tax Abuses

• Regulatory reporting & domicile oversight
• Certified audited financial statements
• Employ of qualified 3rd party service providers
• Documentation is very important for transparency
• All are helpful, but may not fully mitigate abuses
Summary

- Many of the issues raised in the OECD report related to captives can be correlated in one way or another to the captive’s insurance operations. If sufficient and routine consideration is given to the assessment of the captive’s tax position, this could mitigate or resolve many of the OECD’s concerns. Establishing a formal documentation process that addresses the various aspects as mentioned in this presentation is very important and will result in increased transparency. Clearly outlining how the captive has considered the arm’s-length concept, use of qualified third-party service providers, sound actuarial techniques and significant federal and state regulatory oversight will prove the necessary due diligence to comply with IRS, OECD and other foreign regulatory regime requirements.

- Current tax code exists in the US to address concerns related to transactions with foreign entities with ties to US shareholders. Many foreign captives insuring US risks have considered or should consider the 953(d) election to avoid complexity and costly expense to comply with the CFC rules. These rules have been designed to help prevent some of the same concerns raised by the OECD.
Thank you for Attending Today’s Webinar!
Appendix I: Captive Industry Development Timeline
## Captive Industry Development Timeline

<table>
<thead>
<tr>
<th>Time</th>
<th>Action</th>
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</thead>
<tbody>
<tr>
<td>1700’s</td>
<td>• References indicate mutual insurance companies began forming in England to provide insurance to the shipping industry.</td>
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<tr>
<td>1800’s</td>
<td>• The first American captives (mutual's) were formed by textile manufacturers in response to high fire insurance rates of that time period.</td>
</tr>
<tr>
<td>1860</td>
<td>• A group of London merchants formed their own insurance company called Commercial Union in response to increased insurance rates in 1860.</td>
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</tbody>
</table>
| 1920’s and 1930’s | • Several major companies, including British Petroleum and Unilever in the UK and Lufthansa in Germany, formed their own insurance companies.  
• In 1935 the first US captive, likely the Mahoning Insurance Company, was established by the Youngstown Sheet & Tube Company. They wrote a single, all-lines policy with Lloyd’s of London when rigid insurance laws prohibited Youngstown from obtaining such a policy from the conventional market. |
### Captive Industry Development Timeline Cont.

<table>
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| 1950’s | • Fred Reiss formed an insurance subsidiary for a US mining client when he was unable to find an insurance company to cover his client’s multiple risks. He coined the name “captive” from his mining client who referred to its mines as “captive mines”.
  • Licensing captives was prohibitively expensive. Regulators in the US, UK and many European countries did not acknowledge the controlled risks of a captive would result in less exposure to loss. They required captives to have the same level of capital as traditional insurance companies. |
| 1960’s | • Reiss began to search for other jurisdictions that would understand the nature of captives.
  • In 1962 Reiss convinced the Government of Bermuda to pass a special Act of Parliament to allow the formation and management of captives from the Island for international clients |
## Captive Industry Development Timeline Cont.

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| 1970’s | • Major reinsurance companies and the direct insurance market began to realize clients that retained a portion of their own risk were likely to manage these risks more effectively.  
• The European reinsurance market (Swiss Re, Mercantile & General Re and Lloyds of London), together with General Re of America, drove the development of reinsurance pools. Criteria used by the underwriting committees encouraged the use of risk engineering programs to establish credible probable loss estimates and to encourage risk improvement.  
• Hundreds of captives were formed in response to the return of restrictive underwriting in lines such as product liability and medical malpractice. This caused workers’ compensation and liability rates to skyrocket.  
• Realizing they were missing out on a lucrative source of business, various state legislatures started passing laws granting captive insurance companies the same benefits they could derive offshore. |
## Captive Industry Development Timeline Cont.

<table>
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<th>Time</th>
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| 1980’s | • By 1980 the number of captives worldwide increased to 1,000.  
          • Domicile locations increased with the growth of the captive industry.                                                        |
| 1990’s | • A soft market during the 1990’s slowed the growth of captives.                                                                        |
| 2000’s | • Insurers tightened underwriting practices.  
          • After the September 11, 2001 attacks, one-third of property and casualty carriers lost significant value.                  |
| 2010’s | • Interest in captives is at an all-time high.  
          • As of 2013, the industry has about 6,500 captive insurance companies around the world.  
          • As of 2013, the industry has nearly 60 domiciles around the globe.  
          • Focus on increased tax transparency is driving more collaboration among governments. |
Appendix II: OECD Action Plan
ACTION 1 — Address the tax challenges of the digital economy

• Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterization of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector. A report identifying the issues and possible actions to address them will be issued. [September 2014]
ACTION 2 — Neutralize the effects of hybrid mismatch arrangements

- Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralize the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor; (iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and (v) where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be co-ordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping. [September 2014]
**ACTION 3 — Strengthen CFC rules**

- Develop recommendations regarding the design of controlled foreign company rules. This work will be co-ordinated with other work as necessary. [September 2015]

**ACTION 4 — Limit base erosion via interest deductions and other financial payments**

- Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be coordinated with the work on hybrids and CFC rules. [September 2015]
ACTION 5 — Counter harmful tax practices more effectively, taking into account transparency and substance

- Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be coordinated with the work on hybrids and CFC rules. [September 2014 and December 2015]
ACTION 6 — Prevent treaty abuse

- Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be coordinated with the work on hybrids. [September 2014]

ACTION 7 — Prevent the artificial avoidance of PE status

- Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be coordinated with the work on hybrids. [September 2015]
ACTIONS 8, 9, 10 — Assure that transfer pricing outcomes are in line with value creation

ACTION 8 – Intangibles

- Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; [September 2014] (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; [September 2014] (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; [September 2015] and (iv) updating the guidance on cost contribution arrangements. [September 2015]

ACTION 9 – Risks and capital

- Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. [September 2015]
ACTION 10 – Other high-risk transactions

- Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be re-characterized; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses. [September 2015]

ACTION 11 – Establish methodologies to collect and analyze data on BEPS and the actions to address it

- Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions. [September 2015]
ACTION 12 – Require taxpayers to disclose their aggressive tax planning arrangements

• Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of “tax benefit” in order to capture such transactions. The work will be coordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations. [September 2015]

ACTION 13 – Re-examine transfer pricing documentation

• Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNE’s provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template. [September 2014, Discussion Draft issued January 2014]
ACTION 14 – Make dispute resolution mechanisms more effective

- Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases. [September 2015]

ACTION 15 – Develop a multilateral instrument

- Analyze the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution. {September 2014 and December 2015}
Appendix III: Transfer Pricing – Section 482 Methods
Transfer Pricing – Section 482 Methods

1. **Services Cost Method** – allows for certain specified services to be charged at cost

2. **Comparable Uncontrolled Service Price Method** – uses the actual price charged as compared to third parties

3. **Gross Services Margin Method** – uses a comparison of the gross margin of the transaction compared to third-party transactions

4. **Cost of Services Plus Method** – uses the comparison of a gross services profit markup as compared to independent companies

5. **Profit Split Method** – allocates profit based on the value of contribution made by each of the parties involved in the transaction

6. **Comparable Profits Method** – uses various financial ratios, such as the operating margin or the total services costs plus ratio, of the least complex entity in the transaction as a comparison to independent companies
Appendix IV: Transfer Pricing – OECD Guidelines Methods
Transfer Pricing – OECD Guidelines Methods

1. **Comparable uncontrolled price method (CUPS)** — uses the actual price charged as compared to third parties

2. **Resale price method** — uses a comparison of the gross margin of the transaction compared to third-party transactions

3. **Cost plus method** — uses the comparison of the markup incurred as a comparison to independent companies

4. **Profit split method** — allocates profit based on the intangibles owned and contributed by each party to the intercompany transaction

5. **Transactional net margin method** — similar to the comparable profits method, uses various financial ratios of the least complex entity in the transaction as a comparison to independent companies