

CAPTIVE INSURANCE & CORPORATE TAX

VMW TAXAND

TAX REVIEW

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VMW TAXAND

ATTORNEYS AT LAW · TAX LAWYERS · CIVIL LAW NOTARY



The Situation

- Many insurance companies have transferred part of their risk portfolio through re-insurance with group captives in tax jurisdictions where they can save taxes through tax facilities or low tax rates, such as Ireland and Luxembourg.
- The authorities in many cases argue that the insurance company has shifted taxable profits to the captive, resulting either in exit toll or transfer pricing adjustments leading to increased corporate taxes.
- Rutger Hafkenscheid of VMW Taxand has successfully reviewed for a number of Dutch insurance companies whether indeed taxable profits were transferred.
- Such review can support discussions with the authorities and can help to assess the company's litigation position.
- In situations where the method was applied, the analysis has supported a satisfactory solution with the authorities. Although the method was used in situations involving Dutch insurance companies, it can equally be applied in other jurisdictions.
- This presentation describes the methodology used and the deliverables of such review.

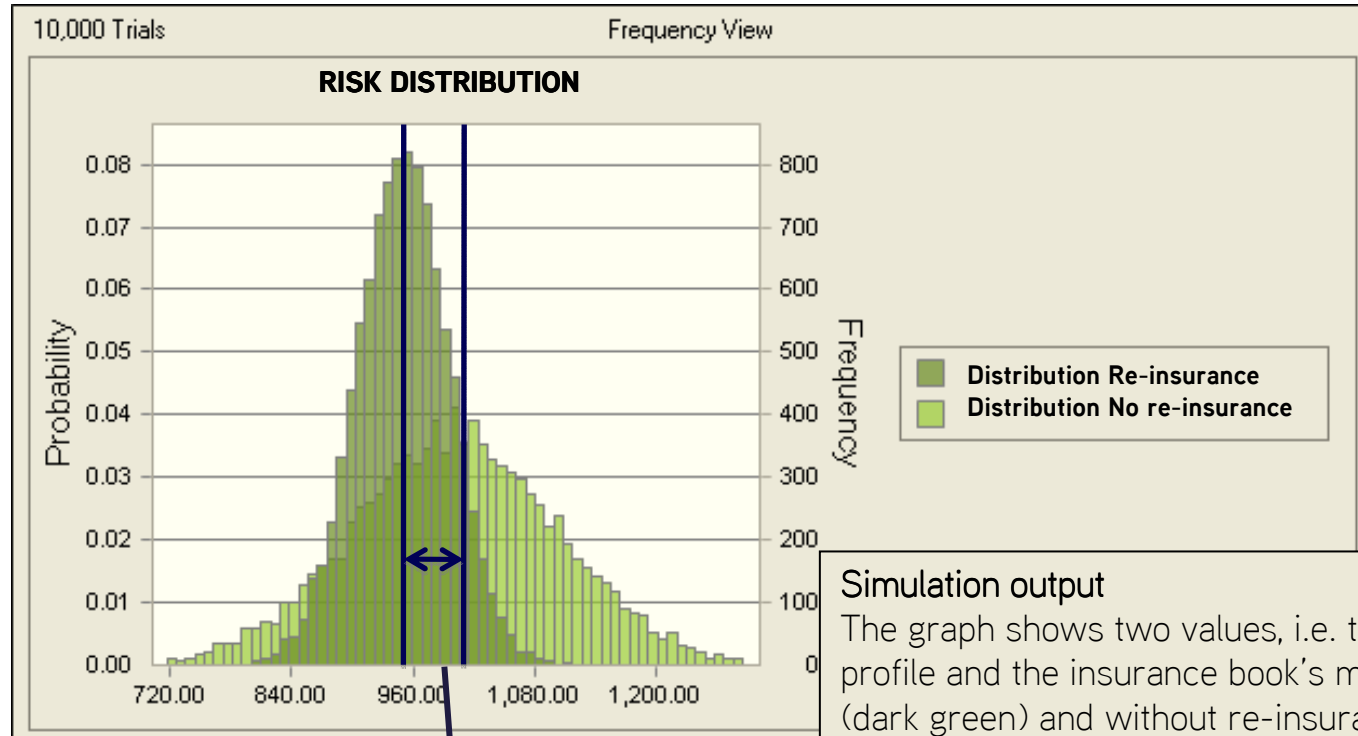
The Background

- The aim of re-insurance is to reduce the risk profile of an insurance book by ceding the risks to a re-insurance company against a premium.
- Theoretically, re-insurance with a captive is acceptable for tax purposes, to the extent that the re-insurance premium is at arm's length.
- Many tax payers try to support the arm's length character of the premium by producing comparables, i.e. third party re-insurance policies or transfer pricing studies.
- The authorities, however, often claim that re-insurance with a captive is inherently not at arm's length, because the re-insurance does not reduce the insurance book's risk profile.
- The method therefore reviews to which extent the re-insurance treaty changes the Dutch insurance book's risk profile, instead of reviewing merely the arm's length character of the premium.

The Method

- The method simulates the financial risks of the insurance book with and without re-insurance based on the uncertain variables affecting the portfolio.
- This simulation enables to compare
 - the insurance book's risk profile with and without re-insurance;
 - the mean (average) of the insurance book's cashflows with and without re-insurance.
- For an example of the deliverable, see next page.

The Deliverable: simulation output



Is the difference between both means at arm's length?

Risk premium & arm's length premium

VMW Taxand establishes the risk premium by calculating at which level of discount rate the means of the situation with and without reinsurance are the same.

Simulation output

The graph shows two values, i.e. the insurance book's risk profile and the insurance book's mean in the situation with (dark green) and without re-insurance (light green). The x-axis shows the range of possible outcomes, the y-axis the outcome's frequency based on a simulation analysis. In an arm's length situation, the risk profile of the portfolio without re-insurance will be more volatile than that of the portfolio with re-insurance. In the graph, the light green Bell curve is wider shaped than the dark green, which shows that the chance of loss or profit in case of re-insurance is smaller than with. Based on multiple simulations, Taxand will review to which extent the re-insurance treaty is at acceptable.

The Approach

- Based on historical financial data, VMW Taxand will build an ex ante financial forecast model.
- Together with the insurance company, VMW Taxand will analyse the portfolio's most sensitive risk drivers.
- VMW Taxand will run a simulation analysis based on the most sensitive risk drivers, within predetermined ranges of input applicable to both the situation with and without re-insurance.
- The simulation results will be compared and, if necessary, VMW Taxand runs additional simulations to establish the arm's length relation between risk transferred and reduced yield.
- The simulation results will be summarised and explained in a report. The report can be used for either internal decision making, explanation to the Board and support in the discussions with the tax authorities.
- If needed, VMW Taxand will support your discussions with the tax authorities.

The Team



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