

Captives and transfer pricing

*Dr Alexander Ressos, TEP
Attorney-at-Law (Switzerland), Solicitor (Hong Kong),
Solicitor (England & Wales)*

Because a captive receives premiums from companies of the same group, every premium is a related-party transaction. The tax authorities of the countries in which the insured subsidiaries are resident therefore ask whether the premium corresponds to what an independent insurer would have charged, and whether the captive really bears the risk for which it is paid. For many years the answers depended on national practice and on the general principles of the OECD Transfer Pricing Guidelines. In February 2020 the OECD published guidance on financial transactions that includes a section devoted to captive insurance, later incorporated as Chapter X of the Guidelines.¹

The guidance builds on the analysis of risk developed in the work on Actions 8 to 10 of the BEPS project. A captive can be remunerated for bearing a risk only if it has the capability to control that risk and the financial capacity to bear it. Control requires decision-makers with the competence to decide on the acceptance of risks, the pricing and the reinsurance, which excludes a shell company whose decisions are in fact taken at the headquarters of the group. Financial capacity requires capital sufficient to pay the claims that may reasonably be expected. The guidance further asks whether the captive diversifies and pools risks, since insurance involves the reduction of risk through the law of large numbers. A captive that covers a single risk of a single subsidiary may not perform an insurance function at all.²

Where the transaction is recognised, the premium must be priced at arm's length. The guidance mentions comparable uncontrolled prices, where independent insurers write similar risks, and actuarial analysis of expected losses with a reasonable return on the capital of the captive. It also deals with fronting and with situations in which the captive benefits from synergies, for example when a group sells extended warranties to its customers and the premiums are routed to its captive. In that case the

guidance indicates that the profit from the sale should be attributed largely to the group company that has the customer relationship.³ For the Basel groups, whose captives cover property, liability and trial risks of many subsidiaries, the guidance usually confirms the substance of the arrangement. It requires, however, that the documentation shows the governance of the captive, the actuarial basis of its pricing and the independence of its decisions.

Switzerland applies the arm's length principle under the general rules on the determination of taxable profit. A premium in excess of the arm's length level paid by a Swiss subsidiary to a foreign captive would be a hidden profit distribution, while an undercharged premium paid to a Swiss captive by foreign subsidiaries would invite adjustments abroad.⁴ Premiums for direct insurance with a Swiss risk location are subject to the federal stamp duty on insurance premiums, generally at five per cent. Reinsurance premiums are not subject to the duty, which is one reason why Swiss captives are mostly reinsurers and why the stamp duty is collected on the premium paid to the fronting insurer.⁵

1 Notes

1. OECD, Transfer Pricing Guidance on Financial Transactions: Inclusive Framework on BEPS Actions 4, 8–10 (11 February 2020), Section E (captive insurance), incorporated into Chapter X of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2022 edition). To be verified. ↩
2. OECD Transfer Pricing Guidelines (2022), Chapter X, Section E, in particular the discussion of the conditions for the recognition of a captive insurance transaction (diversification and pooling of risk, regulated status, capacity to control and bear risk) and of the pricing of premiums. Paragraph numbers to be verified. ↩
3. OECD Transfer Pricing Guidelines (2022), Chapter X, Section E, on the pricing of captive insurance premiums (comparable uncontrolled price, actuarial analysis, combined ratio and return on capital) and on agency sales and group synergies. To be verified. ↩
4. On the arm's length principle in Swiss tax law, in particular the concepts of hidden profit distribution (verdeckte Gewinnausschüttung) and hidden capital contribution under Art. 58 of the Federal Direct Tax Act (DBG, SR 642.11) and the corresponding withholding tax consequences (Art. 4 VStG), see the Swiss tax literature. To be verified. ↩

5. Federal Act on Stamp Duties of 27 June 1973 (StG, SR 641.10), Arts. 21 ff. (stamp duty on insurance premiums, generally 5 %, with exemptions including reinsurance and certain life insurance). To be verified. ↩

For general information only. This article does not constitute legal or tax advice, does not replace advice on an individual case and creates no lawyer-client relationship. It reflects the legal position as of September 2026.

Online version: helveticaregister.com/basel-captives-and-transfer-pricing