

A Tax Incentive for Captive Insurance



British Columbia is a leading domicile for captive insurance

Tax and Cost Advantages

- Tax deferral for captive insurance premiums
- No federal excise tax
- No provincial income tax on foreign risks
- The 2012 federal corporate tax rate is 15% on foreign risks; 25% on domestic risks
- Deductibility of loss reserves
- No requirement to establish residency offshore
- Low tax risk
- Ability to utilize any captive losses against other Canadian income
- Offshore structures may mean increased costs of operation
- No tax benefit for taking Canadian risks offshore

Compatibility of local language, currency and customs

A positive regulatory environment

- Flexible captive insurance legislation
- No specific solvency ratios
- Easy access to reinsurance markets
- Considerable latitude in the scope of allowable investments

Reasonable capitalization requirements:

- Cdn \$200,000 minimum share equity
- Availability of high quality professional services

Economic, political and social stability

Time zone convenience for Pacific Rim and North America

A company registered in British Columbia's International Business Activity (IBA) program qualifies for a full refund of provincial income tax, attracting only the federal corporate income tax rate of 15% in 2012.

Income earned by a registered company on insuring foreign risk of a non-resident qualifies for a refund of provincial tax

According to the *International Business Activity Act* (IBAA) paragraph 2(2)(h), insuring or reinsuring prescribed risks

- (i) of, or relating to, non-resident persons, and
- (ii) relating to property situated or events occurring outside of Canada

is eligible for a full refund of provincial tax for companies registered in the IBA program.

Prescribed risks, as defined in the *IBAA Regulation* section 4.3, are any risks that fall within any class of insurance defined under the *Insurance Act*, except life, sickness or accident insurance.

Under section 4 of the IBAA, non-arm's length transactions are permitted as long as the captive insurance company is licensed under the *Insurance (Captive Company) Act*.

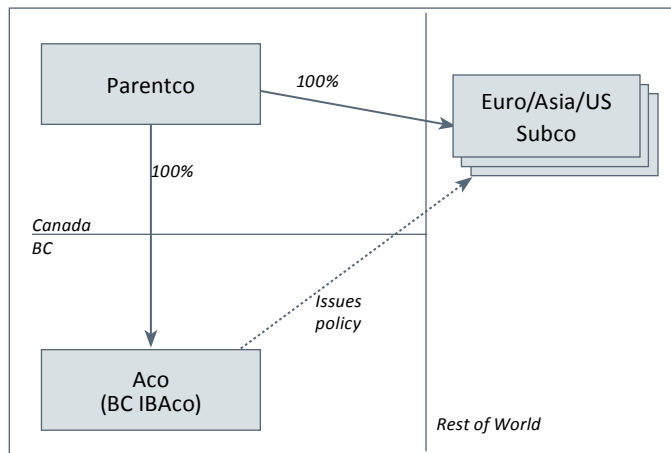
The benefits of locating onshore

- A captive domiciled onshore is a domestic insurer for Canadian tax. Offshore captives may be subject to federal excise tax (10% of premiums) on Canadian risks.
- An onshore captive means lower costs for audit and legal fees, travel, and management in British Columbia.
- There are fewer tax risks or governance issues associated with onshore structures.
- Valuable executive time is not required for travel and meetings.

A simple captive structure can reduce the effective tax rate to 15% in 2012

Fact Pattern

- Parentco decides to cover its insurance needs with a wholly owned subsidiary and establishes a captive insurance company, Aco.
- Aco is located in B.C. and licensed under the *Insurance (Captive Company) Act*.
- Parentco has affiliates in Canada, as well as globally, which carry on active business in the US, Asia, and Europe.
- Subco's insure their risk with Aco, paying \$2m premiums.
- Aco registers with the Province of B.C. as an international business. This entitles Aco to a full refund on provincial tax paid on corporate income on international qualifying business.



An illustration

Assuming

Premiums of \$2 million annually	\$ 2.0m
Loss reserve (80%)	\$ 1.6m
Average global tax rate	35%
Canadian federal tax rate (2012)	15%
B.C. tax rate	10%
IBA tax rate	0%
Costs to manage/maintain in B.C.	\$ 60,000

Analysis

Tax deferred	\$ 700,000
—based on \$2.0m at a 35% tax rate	
Tax paid (Federal and provincial)	\$ 85,000
—based on [(\$2.0m - \$1.6m) - \$60k costs] at a 25% rate	
IBA tax refund	\$ (34,000)
—based on [(\$2.0m - \$1.6m) - \$60k costs] at 10%	
Net taxes paid	\$ 51,000
Net deferral	\$ 649,000

Analysis

- Aco is carrying on an IBA qualifying business: insuring property of a non-resident outside of Canada is an eligible international activity.
- As a registrant in the IBA program, Aco can claim a refund of B.C. corporate income taxes paid on income earned from insuring non-resident affiliates. (Income earned on insuring affiliates in Canada would be subject to federal and provincial tax.)
- In this Illustration, Aco pays \$85k in federal and provincial tax on the premiums, which is partially offset by a refund (\$34k) of the provincial tax of 10%. Thus the effective tax rate paid by Aco is 15%.
- Parentco's affiliates can generally deduct premiums paid to Aco as long as there is 1) bona fide transfer of risk; 2) the amount of the premium meets 'reasonableness' tests.
- Since Aco is located in B.C., no Canadian federal excise tax applies.
- The foreign affiliates may be subject to premium taxes; the actual tax will vary based on the location of risk.
- Aco can deduct loss reserves according to the rules in the *Income Tax Act (Canada)*
- Aco can normally flow earnings to its parent free of tax in the form of dividends.

Employees of registered companies may qualify for provincial income tax refunds

A company in the IBA program can register employees as International Business (IB) Specialists

- Registered IB Specialists can claim a refund of their British Columbia tax on qualifying employment income. The refund is 100% for Years 1 and 2; 75% for Year 3; 50% for Year 4; and 25% for Year 5.
- To qualify, the employee must earn a minimum annual compensation of \$100,000.
- The IB Specialist must be transferred from outside Canada to provide specific expertise and have an employment agreement in place before arriving in Canada.
- The IB Specialist must spend at least 70% of his or her time on the qualifying international financial business.
- No time requirement applies to employees in administrative support and back-up office services.
- For a related group of program participants, only four employees in administrative support and back-up office services may qualify.

A company in the IBA program can register the key decision maker(s) as an Executive Specialist

- Registered Executive Specialists can claim a refund of British Columbia tax on qualifying employment income. The refund is 100% in Years 1 and 2; 75% in Year 3; 50% in Year 4; and 25% in Year 5.
- To qualify, the employee must earn minimum annual compensation of \$250,000.
- This compensation must be included in calculating the program participant's international financial business income.
- For a related group of program participants, only two Executive Specialists may qualify.
- The employee must have been a non-resident before entering into the employment contract. The employee must apply for registration by December 31 of the year in which he or she becomes resident of Canada.
- The employee, and any person related to him or her, must deal at arm's length with the registered corporation.

Further information

AdvantageBC International Business Centre • Vancouver (formerly the International Financial Centre British Columbia) was established in 1986 to attract international business to British Columbia by promoting the legislated tax incentive available through the International Business Activity (IBA) program. AdvantageBC communicates the tax incentive program as well as the many advantages British Columbia offers as a location for corporate investment, including an educated and multilingual workforce, an outstanding telecommunications infrastructure, clean and competitive energy, and a high quality of living. For further information, please visit the website of AdvantageBC at www.advantagebc.ca.

The International Business Activity (IBA) program is administered by British Columbia's Ministry of Finance. To qualify, companies must meet certain criteria; please refer to the Ministry's website at www.sbr.gov.bc.ca/business/Income_Taxes/International_Business_Activity/iba.htm for details.

The information contained herein is provided for convenience and guidance only and is not a replacement for the legislation. Businesses considering accessing the benefits under the *International Business Activity Act* (IBAA) should consult with their professional advisors on the applicability of the legislation to their particular circumstances.

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