

Captive Insurance in British Columbia

Canada's choice for captive insurance



British Columbia is a leading domicile for captive insurance

Taxation

- Tax deferral for captive insurance premiums
- No federal excise tax
- No provincial income tax on foreign risks
- 2010 tax rate of 18% (15% in 2012) on foreign risks; 28.5% (25% in 2012) 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

Income earned by a captive registered in the International Business (IB) program and insuring non-resident property or events qualifies for a full refund of provincial income tax, incurring only the federal corporate income tax rate of 18% in 2010, reducing to 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 IB program.

Prescribed risks, as defined in the *IFA 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*.

In 2012, a company in the IB program may have a net corporate income tax rate of 15%

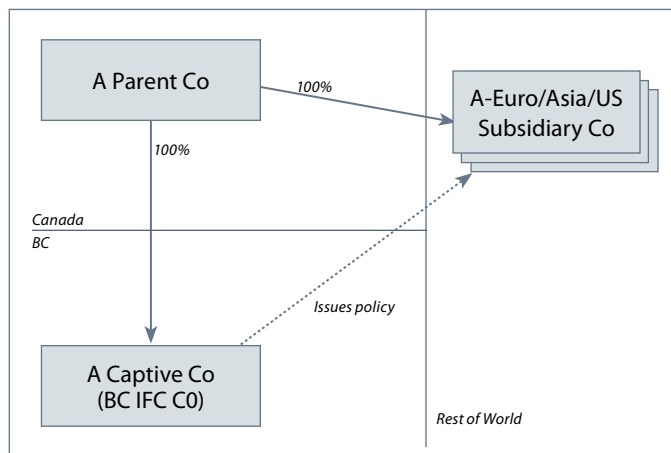
- Canada is reducing the federal corporate income tax rate to 15% by 2012. The rate was reduced to 18% on January 1, 2010 and will be further reduced on January 1 of the following years:

2011	16.5%
2012	15.0%
- The corporate tax rate in British Columbia was reduced on January 1, 2010 to 10.5%. Further reductions are scheduled to lower the corporate income tax rate to 10% as of January 1, 2011.
- With these reductions, Canada's corporate tax rate of 15% will be the lowest of the G7 nations.

A simple captive structure can reduce the effective tax rate to 18% in 2010 and 15% in 2012

Fact Pattern

- A Parent Co decides to cover its insurance needs with a wholly owned subsidiary and establishes a captive insurance company, A Captive Co.
- A Captive Co is located in B.C. and licensed under the *Insurance (Captive Company) Act*.
- A Parent Co has affiliates in Canada, as well as globally, which carry on active business in the US, Asia, and Europe.
- A Subsidiary Co's insure their risk with A-Captive Co, paying \$2m premiums.
- A Captive Co registers with the Province of B.C. as an international business. This entitles A Captive Co 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 (2010)		18%
B.C. tax rate (2010)		10.5%
IFC tax rate		0%
Costs to manage/maintain in B.C.	\$	60k

Analysis

Tax deferred	\$	700,000
—based on \$2.0m at a 35% tax rate		
Tax paid (Federal and provincial)	\$	96,900
—based on [(\$2.0m - \$1.6m) - \$60k costs] at a 28.5% rate		
IFC tax refund	\$	(35,700)
—based on [(\$2.0m - \$1.6m) - \$60k costs] at 10.5%		
Net taxes paid	\$	61,200
Net deferral	\$	638,800

Analysis

- A Captive Co is carrying on a qualifying business: insuring property of a non-resident outside of Canada is an eligible international activity.
- As a registrant in the IB program, A Captive Co 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 the Illustration, A Captive pays \$96.9k in federal and provincial tax on the premiums, which is partially offset by a refund (\$35.7k) of the provincial tax of 10.5%. Thus the effective tax rate paid by A Captive Co is 18%, the federal rate in 2010 (being reduced to 15% by 2012).
- A Parent Co's affiliates can generally deduct premiums paid to A Captive Co as long as there is 1) bona fide transfer of risk; 2) the amount of the premium meets 'reasonableness' tests.
- Since A Captive 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.
- A Captive Co can deduct loss reserves according to the rules in the *Income Tax Act* (Canada)
- A Captive Co can normally flow earnings in the form of dividends to its parent free of tax.

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 offshore structures.
- Valuable executive time is not required for travel and meetings.

Employees of registered companies may obtain a refund of their personal B.C. income tax

IB Specialist

- Specialists are entitled to receive a refund on British Columbia personal income tax.
- The remuneration minimum is \$100,000 ('remuneration' to be defined).
- Refunds of B.C. personal income tax are paid 100% in Years 1 and 2; 75% in Year 3, 50% in Year 4, and 25% in Year 5.
- Patent activities do not qualify for registration.
- 70% is the minimum time required to be spent on the activity.
- The employee must be a non-resident of Canada immediately before entering into a written employment contract with the registered corporation.

The Executive Specialist (ES)

- The ES must be a member of executive management.
- The remuneration minimum is \$250,000 ('remuneration' to be defined).
- Refunds of B.C. personal income tax are paid 100% in Years 1 and 2; 75% in Year 3, 50% in Year 4, and 25% in Year 5.
- There is no time requirement, but salaries must be expensed to the qualifying business.
- The maximum number allowed is 2.
- The employee must be a non-resident of Canada immediately before entering into a written employment contract with the registered corporation.

The International Financial Centre British Columbia (IFC BC) is a non-profit society, established in 1986, with a mandate to communicate the many advantages British Columbia has to offer as a location for corporate investment, including an educated and multilingual workforce, an outstanding telecommunications infrastructure, and a high and clean standard of living.

For further information, please visit the [website](http://www.ifcbc.com) of the IFC BC at www.ifcbc.com or you can access the [website](http://www.canadiancaptive.com) of the Canadian Captive Insurance Association at www.canadiancaptive.com.

Further information

The IFC BC 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. The IFC BC 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, and a high standard of living.

For further information, please visit the website of the IFC BC at www.ifcbc.com or you can access the website of the Canadian Captive Insurance Association at www.canadiancaptive.com.

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The International Business Activity (IBA) program is administered by British Columbia's Ministry of Finance (formerly the Ministry of Small Business and Revenue). 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 here 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.

May 2010