

Captive Insurance in British Columbia

Canada's first choice for captive insurance



British Columbia leads the way as a domicile for captive insurance

Taxation

- Tax deferral for captive insurance premiums
- No federal excise tax
- No provincial income tax on foreign risks
- Tax rate of 19% (15% in 2012) on foreign risks; 30% on domestic risks
- Deductibility of loss reserves
- No “mind and management” issue
- Low tax risk
- Ability to utilize any captive losses against other Canadian income
- Reduced offshore tax rate may be offset by increased costs of operation
- Reduced offshore tax rate is not available for Canadian risks

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

Compatibility of local language, currency and customs

Time zone convenience for Pacific Rim and North America

Income earned by a captive insuring non-resident property or events qualifies for a full refund of provincial income tax and incurs only the federal corporate income tax rate of 19% in 2009

Income earned on insuring risk qualifies for a full refund of provincial tax

According to the *International Financial Activity Act* (IFAA) (Sec. (2) (2) (h)) insuring or reinsuring prescribed risks

- of, or relating to, non-resident persons, and*
- relating to property situated or events occurring outside of Canada*

is eligible for a full refund of provincial tax under the IFA program.

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

Non-arm's length transactions are permitted as long as the captive insurance company is licensed under the *Insurance (Captive Company) Act* (IFAA, Sec. 4).

Choosing a domicile: onshore vs. offshore

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.
- Lower costs for audit and legal fees, travel, and management in BC
- No tax risk or tax governance issues associated with offshore structure
- Valuable executive time is not required for meetings offshore for tax purposes

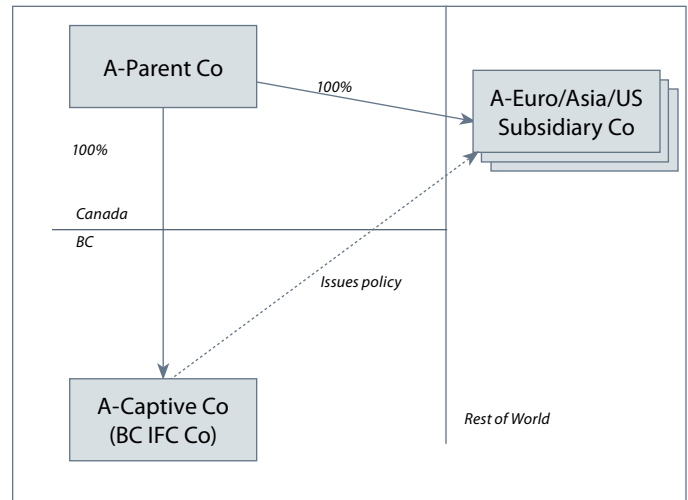
The benefits of locating offshore

- Greater regulatory flexibility. Offshore captives usually allow lower minimum capital requirements and may not require regulatory examinations.
- Taxes on income are negligible.
- Can offer coverages not offered onshore, i.e. certain third party risks
- Greater flexibility to adapt to changing market conditions.

A simple captive structure can reduce the effective tax rate to 19% in 2009 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 located in BC, A-Captive Co.
- A-Captive Co is located in BC 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-Parent Co's subsidiaries insure their risk with A-Captive Co.
- A-Parent Co transfers \$2m to A-Captive Co as a premium for foreign risk.
- A-Captive Co registers with the Province of BC as an international financial business. This entitles 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
Corporate tax rate: foreign, non-Canadian risk		35%
IFC BC tax rate (2009)		19%
Offshore rate		0% to 3%
Costs to manage/maintain	\$	60k (BC)

Analysis

Tax deferred	\$	700,000
—based on \$2.0m at a 35% tax rate		
Tax paid	\$	65,000
—based on [(\$2.0m - \$1.6m reserve) - \$60k costs] at a 19% rate		
Net deferral	\$	635,000

Analysis

- A-Captive Co is carrying on a qualifying business: insuring property outside of Canada is an eligible international financial activity. A-Captive Co can claim a refund of BC corporate income taxes on income earned from insuring non-resident affiliates. (Income earned on insuring affiliates in Canada would be subject to federal and provincial tax.)
- A-Parent Co and 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 BC, no Canadian federal excise tax applies.
- Canadian affiliates are subject to premium taxes; the actual tax will vary based on the location of risk.
- Captive Co can deduct loss reserves according to the rules in the *Income Tax Act (Canada)*
- As a domestic insurer, the captive is not subject to FAPI rules.
- Captive Co can flow earnings in the form of dividends to its parent free of tax.

In certain cases, employees can qualify for a tax refund as well

An employee who comes from outside Canada to work for a company in the IFA program can be registered as an IFA Specialist.

- Specialists are entitled to receive a refund of 75% on British Columbia tax on IFA employment income for a maximum of five years.
- An IFA Specialist must be transferred from outside of Canada to provide a specific expertise and have a written employment agreement in place prior to arriving in Canada.
- A written contract requires that 70% of the individual's time is spent on the international financial business.
- Employees specializing in back-up office services, administrative support services, management services, or patent activities are excluded.

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

- The 2009 federal corporate rate of 19% will be reduced on January 1 of the following years:

2010	18.0%
2011	16.5%
2012	15.0%

- With these reductions, Canada's corporate tax rate will be the lowest of the G7 nations.
- The corporate tax rate in British Columbia was reduced in 2008 to 11% from 12%. Further reductions are scheduled to lower the corporate income tax rate to 10.5% as of January 1, 2010 and 10% as of January 1, 2011.

Contact the IFC BC

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The International Financial Activity (IFA) 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_Financial_Activity/ifa.htm for details.

The International Financial Centre British Columbia (IFC BC) is a non-profit society, established in 1986, for the purpose of communicating 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 standard of living.

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 Financial Activity Act (IFAA) should consult with their professional advisors on the applicability of the IFAA legislation to their particular circumstance.

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