

Tax News

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Good news for Barbados Qualifying Insurance Companies

On September 19, 2008, in response to a request sent to them some three years earlier, the Canadian Revenue Agency (“CRA”) issued a technical interpretation confirming that a Barbados Qualifying Insurance Company (“QIC”) that is a controlled foreign affiliate of a Canadian resident corporation would be considered to be a resident in Barbados for the purposes of Part LIX of the Income Tax Regulations to the *Income Tax Act (Canada)* (the “Regulations”).

In their technical interpretation, the CRA stated that they would consider the QIC, provided that it was “centrally managed and controlled” in Barbados, to be liable to tax in Barbados and therefore a Barbados resident for purposes of Article IV of the Canada/Barbados Double Taxation Treaty (“the Treaty”), and subject to subsection 5907 (11.2) of the Regulations, to be resident in Barbados for purposes of Part LIX of the Regulations.

Generally, the effect of this interpretation is to confirm that a QIC receiving insurance premiums from related companies that carry on active businesses outside of Canada, and are resident in a country which maintains a tax treaty with Canada, should generate exempt surplus in respect of this income. Dividends received by a Canadian resident corporation from the QIC’s exempt surplus, in respect of the corporation, should not be subject to tax in Canada. This exempt surplus treatment applies irrespective of whether a QIC is deemed to be carved out of the Treaty under the provisions of Article XXX (3), which prohibits companies entitled to any special tax benefits in Barbados under the *International Business Companies Act, Cap. 77*, or any similar law enacted by Barbados in addition to, or in place of that law, from benefitting from the Treaty until such time as the Treaty is amended.

This is good news indeed for those Canadian corporate owned captive insurance companies who have postponed “converting” to a QIC or those who have converted, but have delayed distributing dividends back to their Canadian parent companies.

History of EICs and QICs in Barbados

To put this in perspective, we will briefly outline the history and evolution of Exempt Insurance Companies (“EICs”) and QICs in Barbados. The *Exempt Insurance Act, Cap. 308* was legislated in 1983 to encourage multi-national companies to use Barbados as a jurisdiction for their captive insurance businesses. Companies conducting international insurance under the provisions of this Act enjoy not only effective corporate income tax exemption, but also a range of other tax benefits, including exemptions from, or concessional rates for, value added tax, stamp duty, property transfer tax, premium tax, exchange controls, withholding taxes and certain expatriate employees’ income taxes.

Initially, Canadian-owned EICs were able to repatriate dividends to their parent companies tax-free. In 1996, the CRA issued a technical interpretation which stated that because EICs were not paying meaningful taxes in Barbados, they would not be viewed as “liable to tax” for purposes of being a resident under the Treaty as required by Regulation 5907(11.2)(c) which was effective for income earned after 1995.

In response to this, the *Insurance Act, Cap. 310* was amended in 1998 by the *Insurance (Miscellaneous Provisions) Act, 1998* (“the Act”), which provided for the integration of international and local insurance business in Barbados by permitting companies registered as local insurers under the *Insurance Act* to add international business to their present activities and gave international insurance companies the flexibility to move from the *Exempt Insurance*

Act, into the *Insurance Act* in order to transact both international and local business.

An additional related feature of the Act enabled insurers operating under the *Insurance Act* to gain access to an incentive tax rate for that portion of their income derived from outside the Caribbean Single Market and Economy (“CSME”) as defined in section 2 of the *Caribbean Community Act, Cap. 15*: on a formula basis, the 25% corporate tax rate (effective from income year 2006) falls to 1.75% for general insurance business, whilst the 5% rate on gross investment income applicable to life insurers falls to 0.35% (on the non-CSME portion). This rate reduction was achieved by adding international insurance to the list of business activities which qualify for the “foreign currency tax credit” provisions of the *Income Tax Act, Cap 73*. Amendments to this latter Act and its schedules were made to ensure that income from an insurance business is eligible for the credit.

The Act provided that insurance companies registered under the *Insurance Act* would also be able to enjoy an equivalent range of benefits if they comply with a two-part test: at least 90% of their premiums must be derived from outside the CSME region **and** at least 90% of their risks must be situated outside that region. Eligibility for these benefits by an *Insurance Act* registrant is managed by a Certificate of Qualification to be issued by the office of the Supervisor of Insurance.

The Act refers to such Certificate recipients as “qualifying insurance companies”. Failure to meet the two-part test at a future date will lead to the Certificate being cancelled (although it can be reinstated if the test is met once again later on).

The Act originally stated that the amendments would generally have an effective date of August 1, 1998. The one exception dealt with a retroactive application only to those international insurance companies which were licensed under the *Exempt Insurance Act* at any time during the period running from the start of their first income year after 1995 until December 31, 1998. (The Act referred to this period as the “*relevant period*”.)

In order to trigger this retroactive application, such an *Exempt Insurance Act* company must have obtained its *Insurance Act* registration prior to 1999. If this was done, then the tax exemption provisions (in section 29 of the *Exempt Insurance Act*) were to be withdrawn for such a company retroactively for the whole of the “*relevant period*.” Instead, the various new exempting provisions which applied to QICs and the “foreign currency tax credit” relief referred to above would have applied for that same “relevant period,” again with retroactive effect. Due to the uncertainty as to how QICs would be viewed by the CRA, the deadline for registration as a QIC of December 31, 1998 was subsequently amended to December 31, 1999, then 2000 and 2002. In 2004, the *Insurance Act* was again amended such that a Certificate of Qualification issued to an insurer who was previously registered as an EIC shall be deemed to take effect from the

commencement of the income year during which the certificate is issued. In other words there is no longer the possibility of being registered as a QIC retroactively or the requirement to pay corporation tax as if the entity had been registered as a QIC from 1995.

The *Insurance Act* will apply to an insurance company only from the effective date of its registration under that Act. Where a company presently licensed as an *Exempt Insurance Act* company is so registered, the provisions of that Act will cease to apply at the same time as the *Insurance Act* begins to govern. In addition, certain limited provisions of the *Insurance Act* will not apply to (only) the international insurance business of qualifying insurance companies.

Conclusion

The letter from the CRA has put an end to the uncertainty surrounding the Canadian tax treatment of distributions from Barbados QICs to their Canadian parent companies. Canadian companies wishing to locate their international insurance operations outside of Canada can now do so efficiently through Barbados and should consult with their relevant Canadian tax advisors.

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