

DRAFT LEGISLATION TO REFORM CONTROLLED FOREIGN COMPANY REGIME RELEASED

The Assistant Treasurer, the Hon Bill Shorten MP, released exposure draft legislation on the reform of the controlled foreign company (CFC) rules on 17 February 2011.

The main operational effects of the draft CFC legislation now released remain largely in line with the previously released consultation papers that we commented on in our July 2010 update. Uncertainty still exists with regards to the effective date of the proposed legislation but by and large the issues highlighted during the last round of the consultation process, i.e. the potential for captive owners to face severe financial disadvantages compared to traditional insurance buyers seem to have been eliminated by changes made to the initially proposed CFC Group and Integrity rules.

Treasury again asks for comments and submissions by 18 March 2011 but in light of the proposed legislation, we do not deem it necessary to make submissions this time around.

IMPLICATIONS FOR AUSTRALIAN OWNERS OF OFFSHORE CAPTIVES

The main change in the released draft legislation vs. the prior consultation papers lies in the vastly amended “integrity rule”, which in its initial proposed form would have denied an Australian controlling entity a tax deduction for premiums paid to its CFC captive insurance company.

This has now been rectified and the current status quo maintained in that the attributable income (passive income of a CFC) will include the case where the Australian controlling entity obtains a “tax benefit” including a tax deduction.

The proposed changes to the CFC regime will be accompanied by ATO initiatives to increasingly monitor transfer pricing rules. As a consequence, Australian taxpayers using CFC captive insurers for their risk retention and transfer programs need to ensure that premium allocations are commensurate with arm’s length principles such as location of assets and associated risks etc.

CONCLUSION

The redrafted “integrity rule” in the proposed legislation should result in Australian taxpayers utilising a CFC captive insurance company not being disadvantaged and the status quo of current CFC attribution tax application maintained.

Every organisation will need to assess individually how the proposed legislation could affect the financial outcomes of a captive insurance strategy. The exposure draft legislation is available [here](#).

CONTACTS FOR FURTHER DETAILS

Willis Captive Practice Australasia

Peter Lowe : +64 9 920 2997

André Kyburz: + 61 3 8681 9872

George Ong: +65 6591 8075

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