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PROPOSED REFORM OF THE CONTROLLED FOREIGN COMPANY RULES AND ITS EFFECT ON CAPTIVE INSURANCE COMPANIES

The Australian Treasury released their second consultation paper on the reform of controlled foreign company (CFC) rules on 16 July 2010. The paper outlines the proposed rules and changes to the current CFC regime and provides examples to illustrate how the new rules would be applied.

The Government asks for comments and submissions by 31 August 2010 and we expect that the new regime will be implemented by 1 July 2011.

PROPOSED NEW CFC RULES AND POTENTIAL IMPLICATIONS ON AUSTRALIAN OWNERS OF OFFSHORE CAPTIVES

The proposed new CFC rules feature an "active business test" whereby a CFC satisfying this test would qualify to have its profits attributable to an Australian controlling entity (its parent company) exempt from taxation under the attribution tax rules in Australia.

The consultation paper, which can be found at the Treasury website here provides specific examples on the application of the active business income exemption.

Example 18 on page 12 of the consultation paper makes specific reference to an offshore captive insurance company, suggesting that such an arrangement would qualify to be considered an actively conducted business within the boundaries of the proposed CFC regime. Hence profits of the captive insurance subsidiary would not be attributable to its controlling Australian parent company.

However, one of the negative implications of the proposed new regime appears to be that premiums paid to the captive by Australian insured's would no longer be tax deductible.

CONCLUSION

Whilst applicability of CFC rules should be assessed on a case by case basis, we believe that the proposed reform will have broad implications on Australian owners of offshore Captives as outlined above.

Benefits to Australian taxpayers from the relief of attribution tax costs combined with the simplicity and compliance savings inherent with the proposed new regime will be one side of any evaluation whilst the proposed non-deductibility of premiums paid to a captive subsidiary will be a negative outcome.

Every organisation will need to assess individually how these proposed changes will affect the financial outcomes of a captive insurance strategy.

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We **communicate** *with you to* **understand** *your business, providing the* **expertise** *and* **creativity** *to develop and* **deliver** *excellent captive* **solutions**, *and we do so with* **passion**