



# Micro-Captives: The Insurance Company You Keep

*65<sup>th</sup> Annual Taxation Conference  
Austin, Texas  
December 13-14, 2017*

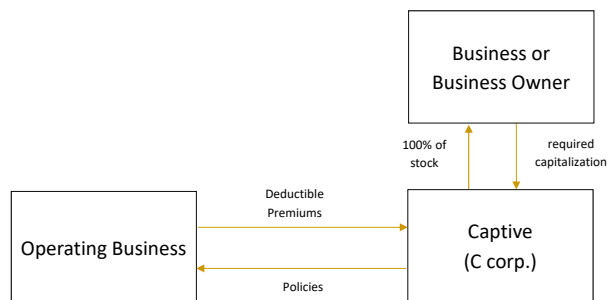
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## What Is a Captive Insurance Company?

- **Captive: Property and casualty insurance company formed by a business or its owners to provide coverage to the business or its affiliates**



## What Is a Micro-Captive?

- **§831 of the Code provides for two types of captives**
  - **§831(b) election – micro-captives**
    - Premiums deductible by insureds
    - Taxed only on investment income, not on premium income
    - Annual premiums ≤ \$2.2 million
  - **§831(a) – large captives**
    - Any non-831(b)-elected captive
    - Premiums deductible by insureds
    - Taxed on underwriting (insurance) income and investment income
    - Annual premiums likely > \$2.2 million

## Why Should I Care?

- **Heavily promoted to small and mid-size business owners**
- **Why?**

## Sample Captive Economics

<b>Income Statement</b>						
	Yr 0	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
<b>Underwriting revenue</b>						
Written Premium		1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
<b>Total Underwriting Revenue</b>		<u>1,000,000</u>	<u>1,000,000</u>	<u>1,000,000</u>	<u>1,000,000</u>	<u>1,000,000</u>
<b>Underwriting Expense</b>						
Risk Pool Losses		(15,300)	(15,300)	(15,300)	(15,300)	(15,300)
Administration Expenses		(64,100)	(52,300)	(52,300)	(52,300)	(52,300)
<b>Total Underwriting Expense</b>		<u>(79,400)</u>	<u>(67,600)</u>	<u>(67,600)</u>	<u>(67,600)</u>	<u>(67,600)</u>
<b>Net Underwriting Profit</b>		<u>920,600</u>	<u>932,400</u>	<u>932,400</u>	<u>932,400</u>	<u>932,400</u>
<b>Investment Income</b>		53,530	102,735	154,296	208,342	264,807
Federal Corporate Income Tax Estimate		(1,832)	(3,917)	(5,767)	(11,456)	(13,273)
<b>Net Income</b>		<u>972,298</u>	<u>1,031,218</u>	<u>1,080,929</u>	<u>1,129,288</u>	<u>1,183,933</u>
Opening Retained Earnings		-	972,298	2,003,516	3,084,445	4,213,733
Closing Retained Earnings		972,298	2,003,516	3,084,445	4,213,733	5,397,666
<b>Balance Sheet</b>						
	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	
<b>Assets</b>						
Cash & Investments	150,000	1,122,298	2,153,516	3,234,445	4,363,733	5,547,666
<b>Total Assets</b>	<u>150,000</u>	<u>1,122,298</u>	<u>2,153,516</u>	<u>3,234,445</u>	<u>4,363,733</u>	<u>5,547,666</u>
<b>Liabilities</b>						
Unearned Premium	-	-	-	-	-	-
<b>Total Liabilities</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Capital and Surplus</b>						
Capital Contribution	150,000	150,000	150,000	150,000	150,000	150,000
Retained Earnings	-	972,298	2,003,516	3,084,445	4,213,733	5,397,666
<b>Total Capital and Surplus</b>	<u>150,000</u>	<u>1,122,298</u>	<u>2,153,516</u>	<u>3,234,445</u>	<u>4,363,733</u>	<u>5,547,666</u>
<b>Total Liabilities, Capital and Surplus</b>	<u>150,000</u>	<u>1,122,298</u>	<u>2,153,516</u>	<u>3,234,445</u>	<u>4,363,733</u>	<u>5,547,666</u>

\* ASSUMES THE INVESTMENT PLAN IS MANAGED FOR C CORPORATION INCOME TAX EFFICIENCY.

## What's the Fuss About?

- **February 2015: IRS "Dirty Dozen" List of Tax Scams**
  - "Another abuse involving a legitimate tax structure..."
  - "In the abusive structure, unscrupulous promoters persuade [businesses] to participate in this scheme..."
  - Promoters create and *sell* "...poorly drafted 'insurance' binders and policies to cover ordinary business risks or esoteric, implausible risks for exorbitant 'premiums,' while maintaining economical commercial coverage..."
  - "The promoters manage the entities' captive insurance companies year after year for hefty fees, assisting taxpayers unsophisticated in insurance to continue the charade."

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First appeared as part of the conference materials for the  
65<sup>th</sup> Annual Taxation Conference session

"Controversies and Transactional Issues (Captive Insurance)"