



Micro-Captives: The Insurance Company You Keep

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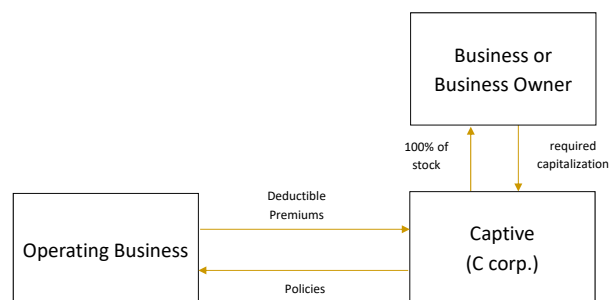
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What Is a Captive Insurance Company?

- **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

Income Statement						
	Yr 0	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
Underwriting revenue						
Written Premium		1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Total Underwriting Revenue		<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>
Underwriting Expense						
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)
Total Underwriting Expense		<u>(79,400)</u>	<u>(67,600)</u>	<u>(67,600)</u>	<u>(67,600)</u>	<u>(67,600)</u>
Net Underwriting Profit		<u>920,600</u>	<u>932,400</u>	<u>932,400</u>	<u>932,400</u>	<u>932,400</u>
Investment Income		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)
Net Income		<u>972,298</u>	<u>1,031,218</u>	<u>1,080,929</u>	<u>1,129,286</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
Balance Sheet						
	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	
Assets						
Cash & Investments	150,000	1,122,298	2,153,516	3,234,445	4,363,733	5,547,666
Total Assets	<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>
Liabilities						
Unearned Premium	-	-	-	-	-	-
Total Liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Capital and Surplus						
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
Total Capital and Surplus	<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>
Total Liabilities, Capital and Surplus	<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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[Controversies and Transactional Issues \(Captive Insurance\)](#)

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"Controversies and Transactional Issues (Captive Insurance)"