Micro-Captives: The Insurance Company You Keep

65th Annual Taxation Conference
Austin, Texas
December 13-14, 2017

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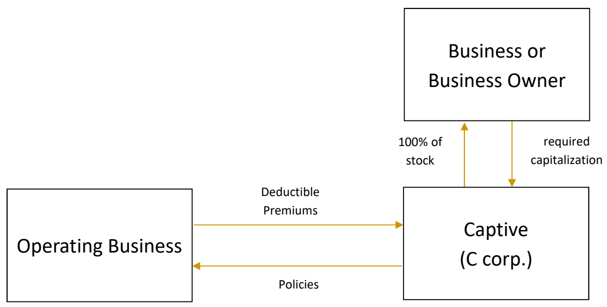
What Is a Captive Insurance Company?

- **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

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		1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
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		(79,400)	(67,600)	(67,600)	(67,600)	(67,600)
Net Underwriting Profit		920,600	932,400	932,400	932,400	932,400
Investment Income		53,530	102,735	154,296	208,342	264,807
Federal Corporate Income Tax Estimate *		(1,832)	(3,917)	(5,767)	(11,455)	(13,273)
Net Income		972,298	1,031,218	1,080,929	1,129,288	1,183,933
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	150,000	1,122,298	2,153,516	3,234,445	4,363,733	5,547,666
Liabilities						
Unearned Premium		-	-	-	-	-
Total Liabilities	-	-	-	-	-	-
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	150,000	1,122,298	2,153,516	3,234,445	4,363,733	5,547,666
Total Liabilities, Capital and Surplus	150,000	1,122,298	2,153,516	3,234,445	4,363,733	5,547,666

* 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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Also available as part of the eCourse
2017 Taxation eConference

First appeared as part of the conference materials for the
65th Annual Taxation Conference session
"Controversies and Transactional Issues (Captive Insurance)"