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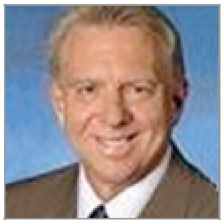

When It’s Good to Be a Captive

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BY ROGER RUSSELL, SENIOR EDITOR, ACCOUNTING TODAY

Captive insurance companies, once the exotic plaything of large corporations, are now open and advantageous to much smaller companies. But most accountants don’t know enough about captive insurance companies to advise their business clients on the advantages of starting their own, according to Brian McCormick and Jerry Messick of Elevate Captives LLC.

“Captive insurance companies exist to serve those that own them,” said Messick, managing director of Elevate Captives. “They’re not new—most large corporations have them. In fact, Allstate was at one time the captive insurance company for Sears.”

Captives actually have been around since the late 1700s in London, according to Messick. While they got their start in the U.S. in the 1920s, it is only in the last two decades that they have seen their greatest growth as taxpayers have understood the risk management, insurance savings, wealth transfer and tax advantage capabilities of captive insurance companies.

“Captives give the owners the opportunity to take control back of not only their expenses but their risk,” explained Brian McCormick, president of Elevate Captives. “There are a lot of areas of risk that are not available in the market. The premium dollar you spend with your own captive is much less than if you go to a commercial carrier, because you don’t have to deal with advertising and marketing. It’s not necessarily to replace the outside carrier, but to take back some of the risk.”

In fact, using a captive insurer can be a risk management technique in which a business forms its own insurance company to finance its retained losses in a formal structure.

With Affordable Care Act mandates delayed until 2015, there is time to explore the captive option, suggested McCormick. “Self-insured health plans are not subject to ACA regulations,” he said. “Because of the ACA there should be greater incentive to explore the self-insured option. The best way for a self-insured plan is through a captive, because then the company is also getting the full tax benefits. There are some tax benefits you don’t get with a self-insured plan that you do with a captive, so it makes sense to have the self-insured plan covered through a captive.”

The cost of setting up a captive and the capital required has dropped significantly, and are no longer a barrier for companies toying with the idea, indicated David Kotowski, chief executive of Elevate Captives. “Captives can reduce commercial insurance premiums,” he explained. “One way is to raise deductibles on your existing policies that have low claims history and insure those deductibles in the captive. The whole concept of captives is to insure risk that you control.”

Other advantages of a captive are significant tax deductions, tax arbitrage, cutting commercial insurance rates, and as an estate planning tool, Kotowski observed.

“Under Section 831(b) of the Internal Revenue Code, a business can deduct up to $1.2 million of insurance premium it pays to a captive insurance company,” he said. “The captive can elect Section 831(b) so that the captive only pays tax on its investment earnings and not on its premiums received or the profits it generates.”

A captive can help convert personal income tax rates to dividend or capital gains rates, he noted. And a business owner can pass a significant amount of assets from a captive to the next generation by having the captive owned by a trust. Since the captive is owned by the trust, every year the business owner can pay up to $1.2 million in premiums to the captive. The profits and reserves of the captive will pass free of estate, gift and generation-skipping tax if structured properly.