Stockpile Wealth By Owning Your Own Insurance Company

For High Income Clients
Who Own Their Own Business or Professional Practice

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It is important to keep in mind when forming a captive one CANNOT choose to do so primarily for the ancillary reasons below. The captive must be formed for the primary reason of enhanced risk management, insurance protection, and asset protection. An experienced attorney and captive management firm in the captive insurance company space will ensure this happens.

Since 2005, we have been in the business of helping clients own their own insurance company. An insurance company is a powerful financial vehicle that can provide tremendous added value to businesses and business owners. In this case, we are describing what is known as a captive insurance company or small casualty insurance company under the Internal Revenue Code section 831 (b).

First and foremost, a captive insurance company can provide more effective risk management and casualty insurance protection to the parent company or companies. This should be the primary purpose of creating a captive insurance company. But, a captive insurance company also affords many ancillary benefits to the business, its owners and its CFO. Owning one or more captive insurance companies can simultaneously also enable business owners to solve for many other financial needs and wants.

Owning a captive insurance company can enable business owners and professionals to more effectively address the following **wants** and **needs**:

- Reduce Insurance Costs
- Improve risk management and insurance protection
- Improve Business and Personal Cash Flow
- Experience Tax Savings
- Improve Asset Protection
- Accelerate Wealth Accumulation
- Facilitate Estate Transfer to Future Generations
- Provide Alternative to Non-Qualified Retirement or Deferred Compensation Plan
- Provide Golden Handcuffs or Golden Parachutes
- Facilitate Buy Sell, Buy In, or Buy Out Arrangements
- Provide Alternative to Qualified Retirement Plans
- Reduce the Costs of Long Term Care
- Protect Assets from Long Term Care Costs

What Is A Captive Insurance Company?

A captive is a unique but REAL casualty insurance company. It includes its own corporation, insurance license, reserves, policies, policyholders, and claims. It is a formal way for business owners to self-insure, and captives are generally formed to insure the risks of owners and related or affiliated third parties.

There are many risks that all businesses regularly face and informally self-insure. It's worth noting that businesses informally self-insure with after tax dollars, meaning that a businesses' "rainy day fund" is usually comprised of retained earnings that have already been taxed. With a captive in place, businesses can formally insure risks not normally insured by third party insurers.

Premiums are paid from the parent company to the captive with tax deductible or pre-tax dollars, and can accumulate tax-free as reserves of the captive (up to $1.2 million annually). Reserves can be transferred into virtually any other type of asset (some domiciles have restrictions). Hence premiums paid are in effect a "transfer of wealth" and are protected from the parent company's creditors and lawsuits.

How Should Captive Assets Be Managed?

In a word – conservatively. The optimal strategy will maintain liquidity, capture upside of market and minimize adverse impact of downturns, minimize taxes, be compliant, and provide maximum expected returns under reasonable assumptions.

NAIC MODEL LAWS, REGULATIONS AND GUIDELINES...COMPANY ORGANIZATION, MANAGEMENT, SECURITIES...Investments of Insurers Model Act (Model 283) -- (Defined Model 283 s 5)

Prudence Evaluation Criteria

The following factors shall be evaluated by the insurer and considered along with its business in determining whether an investment portfolio or investment policy is prudent; the commissioner shall consider the following factors prior to making a determination that an insurer's investment portfolio or investment policy is not prudent:

A. General economic conditions;

B. The possible effect of inflation or deflation;

C. The expected tax consequences of investment decisions or strategies;

D. The fairness and reasonableness of the terms of an investment considering its probable risk and reward characteristics and relationship to the investment portfolio as a whole;

E. The extent of the diversification of the insurer's investments among:

(1) Individual investments;
(2) Classes of investments;
(3) Industry concentrations;
(4) Dates of maturity; and
(5) Geographic areas;

F. The quality and liquidity of investments in affiliates;

G. The investment exposure to the following risks, quantified in a manner consistent with the insurer's acceptable risk level identified in Section 6H:

(1) Liquidity;
(2) Credit and default;
(3) Systemic (market);
(4) Interest rate;
(5) Call, prepayment and extension;
(6) Currency; and
(7) Foreign sovereign;

H. The amount of the insurer's assets, capital and surplus, premium writings, insurance in force, and other appropriate characteristics;

I. The amount and adequacy of the insurer's reported liabilities;

J. The relationship of the expected cash flows of the insurer's assets and liabilities, and the risk of adverse changes in the insurer's assets and liabilities;

K. The adequacy of the insurer's capital and surplus to secure the risks and liabilities of the insurer; and

More Thorough Explanation of Some Ancillary Benefits of Captive Ownership

1) Reduce Insurance Costs –
    a. Conventional third party insurance policies insure a bundle of risks; some of which may not be particularly relevant to you or your business, and yet you pay for both. In other words, you may be paying for coverage that you don't need while "going naked" on coverage that you do need.
    b. Third party insurance premiums also include markups for things like marketing expenses and large underwriting departments, which may not benefit professionals or business owners at all. These additional costs are reduced or eliminated with captive insurance.

    c. Currently, any risks you self-insure are insured with after tax dollars. So, it takes almost $1 million in earnings, with $500,000 or so first paid in taxes, to save $500,000 in a sinking fund to pay for $500,000 of losses incurred. An example is a pain management physician who had competition move into town causing his income to decrease significantly. Because Dr. X had an ownership position in a captive insurance company, he was able to save $1 million before tax via captive insurance premiums to cover his business loss of income vs. $500,000 that he would have saved after tax.
    d. Because a captive insurance company is a licensed insurance company, it has access to the reinsurance market. Utilizing reinsurance can lower insurance costs for many business owners and professionals.

2) Improve Risk Management and Insurance Protection -
    a. Because business owner and professionals are willing to insure real risks that up until now have been considered too remote to insure or too expensive to insure through third party insurance companies, they will experience better risk management and insurance protection.

3) Improve Business and Personal Cash Flow –
    a. Your business can experience improvement in overall after-tax cash flow by obtaining cheaper and more relevant insurance coverage. Additionally, the tax savings associated with CIC ownership positively affects business and personal cash flow.

4) Experience Tax Savings –
    a. Income Tax – Every year you or your business can take a tax deductible business expense of up to $1.2 million (with a limitation of about 20% of gross revenue from all businesses owned).
        i. This tax savings can be as much as **40% to 50%** when considering the combined federal, state and Obamacare tax brackets. This could save about $480,000 to $600,000 in income taxes per year per $1.2 million of captive insurance premiums.

    b. Death Tax – A properly structured captive can be owned by your trust for the benefit of your spouse and children. The estate death tax of 40% on the accumulated profits plus earnings of the captive insurance company would be negated.
    c. The combined effect of a and b above can avoid taxation totaling over 70%.
    d. In addition, a family trust for the benefit of your spouse and children can be structured in such a way that death taxes are not applicable for generations to come. In a sense the captive insurance company has the ability to serve as the family bank.

5) Bolster Asset Protection –
    a. By having the stock of the captive insurance company owned by a family trust, the stock cannot be subject to personal creditors or the creditors of their businesses.

b. Insurance company assets are generally protected by statutory law of the jurisdictions in which they are domiciled. The assets of an insurance company are generally preserved for the benefit of claimants. In other words, the captive's assets can only be accessed to pay claims. And, since the types of insurance coverage an insurance company sells are managed to insure the businesses along with limited insurance coverage sold to other companies, there is almost no likelihood that creditors can access the assets of your insurance company.
c. If your CIC is incorporated in certain international jurisdictions, the laws of the international jurisdiction may make it extremely difficult, if not practically impossible, for any non-policyholder future creditor, especially one in the US, to get to the assets of the company.
d. CIC assets are usually invested in such a way that, even if a creditor were successful in obtaining a judgment against the CIC, the creditor would be thwarted from obtaining much value by doing so. This is accomplished by investing the assets in a special asset protected LLC, where a creditor is limited to a Charging Order.

6) Accelerate Wealth Accumulation –

a. The wealth which you can accumulate from the profits of your captive insurance company is available for many life cycle needs or wants:
   i. Retirement
   ii. Long Term Care
   iii. Education
   iv. Dreams

7) Facilitate Estate Transfer to Future Generations –

a. 4b above not only saves on the cost of death taxes, but it transfers assets from your client's estate to future generations in the most effective method of which we are aware.

8) Function as Non-Qualified Retirement or Deferred Compensation Plan –
    a. Stock ownership in a captive insurance company is a great alternative to supplemental non-qualified retirement plans and deferred compensation plans.

9) Function as Golden Handcuffs or Golden Parachutes –
    a. Stock ownership in a captive insurance company can encourage a key employee to remain with your company.
    b. Stock ownership in a captive insurance company can reward a key employee for past performance, thereby motivating certain key personnel and creating business value.

10) Facilitate Buy Sell, Buy In, or Buy Out Arrangements –
    a. A captive can be very effective in facilitating the purchase of a business, or the buying into a business, or buying out someone from a business.

11) Function as Alternative to Qualified Retirement Plans:
    a. Ownership in a captive insurance company can provide far better accumulations and income for retirement than 401k plans, profit sharing plans, SEP plans and other qualified retirement plans.

As stated at the beginning, it is important to keep in mind, that while all the above ancillary benefits have significant value, when forming a captive one CANNOT choose to do so primarily for the ancillary reasons above. The captive must be formed for the primary reason of enhanced risk management, insurance protection, and asset protection.

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