

LARGE TAX ADVANTAGES FOR BUSINESS OWNERS

Although many think that the concept of captive insurance companies is a relatively new phenomenon, historically there is evidence that the first captives originated in both New London and Norwich, CT when sea captains and textile mill owners formed their own captive consortiums in the 1840's. Only during the last 20 years has the captive insurance industry seen exponential growth as sophisticated taxpayers have realized the risk management, insurance savings, wealth transfer and tax advantages of captive insurance companies. The modern captive movement began about 60 years ago, and today, nearly all major corporations utilize captives and take advantage of the numerous benefits they provide.

WHAT IS CAPTIVE INSURANCE?

Captive insurance companies are insurance companies established for the purpose of financing risks emanating from their parent group or groups. Using a captive insurer is a technique in which a business forms its own insurance company subsidiary to finance its retained losses in a formal structure. In other words, instead of the common parent purchasing insurance from a large third-party insurance company, the common parent instead sets up its own insurance company to cover supplemental risk not catastrophic risk. The term "captive" comes from the fact that the business principals own the insurance company, i.e., the insurer is captive to the entities. Therefore, its business is primarily supplied by and controlled by its owners, which are also normally the principal insureds.

HOW CAN A CAPTIVE HELP?

Captive insurance companies can potentially benefit taxpayers in a number of ways, some of which are highlighted as follows:

Income Tax Savings: Captive insurance companies can also offer dramatic income tax savings because they allow the business owner to reserve for claims on a pre-tax basis. The use of the captive insurance company essentially creates a tax deduction to the operating business that would otherwise have been unavailable. Small captive insurance companies can accept up to \$1.2 mm/year in insurance premiums tax exempt! If the risks that are insured against never materialize, the captive insurance company makes a profit and the operating business keeps its deduction.

Insurance Savings: The first benefit of a captive insurance company is the potential for insurance savings. If the captive's underwriting is successful, the business owner will gather the underwriting profits. Additionally, the business owner may be able to add coverages that are otherwise unavailable or which are prohibitively expensive if purchased on the open markets. The business owner may also be able to use a captive as a tool to leverage insurance brokers into offering commercial coverages at lower rates.

Wealth Transfer: Captive insurance companies also offer the potential for wealth transfer to successive generations without the payment of gift or estate tax.

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