

# THE TEAM WITH THE BEST PLAYERS

## WINS..... Jack Welch

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## Another “Whac-A-Mole” Year

By William York, VP of Marketing



Most of us understand that in the past three years the U.S. economy has evolved.

### **Our Economy is robust!**

The stock market and jobs market have been on a very positive trend. Federal banking policy has turned stable with only slight increases in interest rates. Businesses are growing and unemployment is at an all-time low.

The captive insurance marketplace has also continued to grow in this strong economic environment with the most popular and well-regulated US domiciles enjoying a steady number of new formations and net active captive numbers!

There is no doubt that captive insurance continues to evolve and is slowly replacing a larger segment of the commercial insurance marketplace. This is occurring in spite of the soft commercial insurance marketplace. It certainly proves that

captives are here to stay in spite of the continued assault by the IRS. The important role of captives cannot be underestimated.

While this overall success is evident to many observers, the IRS is continuing its attack on captives by placing micro captives on their “Dirty Dozen” list once again this year. While we don’t agree with the IRS assessment.....we must recognize this reality.

Approximately five years ago the IRS decided that the captive insurance industry was the new target du jour and began listing them on their “Dirty Dozen” list. The IRS sees small captives, many of whom have elected section 831(b) treatment, as problematic for multiple reasons. The IRS believes that owners of these companies are “scamming the system” and have declared their version of “whac-a-mole” on the captive industry.

WHAC-A-MOLE is an arcade game in which players use a mallet to hit toy moles back into their holes. It is also a reference to a situation in which attempts to solve a problem are piecemeal or superficial, resulting in temporary or minor improvement. The industry does not need this approach. Instead it needs the cooperation of the IRS to eliminate their issues of concern. The captive insurance marketplace needs consistent regulatory guidance. It does not need to fear the mallet slammed by the IRS. We need direction, order and consistency.

While the IRS whac-a-mole attitude continues, captives continue to be arguably the largest driving force of innovation in the insurance marketplace. The energy created between the shared ownership of captives and insured allows for unparalleled flexibility in coverage. It allows businesses to create needed coverage that the commercial marketplace shies away from. Remember the captive industry began as a response to a lack of proper coverage, not to cover risks that were new, but to cover risks that were volatile. Congress understood this need and encouraged captive formations. Both sides of the aisle supported and continue to support captive development.

As the captive industry evolved, it subsequently responded to covering risks that were new and cutting edge such as: cyber, blockchain, autonomous vehicle, cannabis, the pervasive and integration of artificial intelligence into our everyday lives. These new risks keep challenging businesses and the captive insurance marketplace to continue its evolution.

The face of this private insurance option represents and will continue to represent future thinking.

Now, imagine that the IRS put down its mallet! Imagine the results that might be possible!

While we don't know whether the root causes of these IRS challenges are political or just ignorance of industry needs, we do know that the better regulated domicile with a strong and active captive insurance association and solid service provider infrastructure will continue to weather these challenges.

Done properly, educated professionals in the captive marketplace understand that captives are formed for risk management and risk financing.

Those individuals that create captives with tax avoidance as the main driver of each formation and who attempt to skirt or cross the line established by the IRS, should be aware that the rubber mallet of the whac-a-mole *will* get them. Hopefully over time this will change. The few bad apples will disappear. But until then we all need to be diligent and continue to be forward thinking.

The future is bright and as captives move steadily into the mainstream of risk management, you can be sure that more and more businesses will bring an end to this whac-a-mole game. The IRS needs to recognize and understand that mid-market businesses need this powerful business tool to remain competitive in the new world economy.

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