

# THE TEAM WITH THE BEST PLAYERS

## WINS..... Jack Welch

Newsletter July 1st, 2020  
Volume 8, Issue 7

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## Creating Greater Financial Security

By William York, VP of Marketing

For decades Captive Insurance Companies have helped many businesses create greater efficiencies and ultimately greater financial security. Many outspoken media pundits, however, have voiced their opposition to these sophisticated planning techniques, vocally claiming that these programs were only created for the upper class, the wealthy business owners.

This exaggerated outcry does not recognize the fact that businesses are created by people who put their own capital and sweat on the line. Not many were handed their wealth on a silver platter. Most spend years of their lives, facing difficulties and overcoming these difficulties to develop businesses that employ hundreds of thousands of people, drive our economy and form the backbone of the American society. Financial security implies that adequate assets exist under the worst of times to weather threats to businesses. Our goal is to create greater financial security, while minimizing the cost so businesses can operate at peak efficiency.



Captive Insurance Companies (CIC) not only protect businesses from threats through the creation of private insurance, but Captives also provide to a business the ability to accumulate assets. Unfortunately, not enough businesses understand the multiple opportunities available with these assets to create even **“Greater Financial Security”**. Captive Insurance companies are real insurance companies regulated by their state of domicile. They act and operate under similar regulations as commercial insurance companies do. They follow the same federal tax laws commercial insurance companies follow.

Captive Insurance Companies are property and casualty insurance companies not life insurance companies. With that in mind, I would like to offer a number of options available when a Captive is established, and proper risk management procedures are put in place by the business owners. Before we begin to elaborate on these many options, first consider the overall advantages available by reviewing the summary below:

### NO CAPTIVE

Net Business Income	\$1,150,000(yr. 1)	\$5,750,000(yr5)	\$11,500,000(yr10)
Income tax (45%)	(\$517,000)	(\$2,587,500)	(\$5,175,000)
After-tax Investment Inc*	\$10,000	\$16,000	\$603,050
<b>TOTAL</b>	<b>\$642,900</b>	<b>\$3,322,500</b>	<b>\$6,928,050</b>

### WITH CAPTIVE

Captive Premium	\$1,150,000(yr1)	\$5,750,000(5)	\$11,500,000(yr10)
Operating Expenses	(\$65,000)	(\$325,000)	(\$650,000)
After -tax Investment Inc*	\$17,900	\$274,000	\$1,034,500
<b>TOTAL</b>	<b>\$1,102,900</b>	<b>\$5,699,500</b>	<b>\$11,884,500</b>
<b>GAIN OVER NO CAPTIVE</b>	<b>\$460,000</b>	<b>\$2,377,500</b>	<b>\$4,956,450</b>

\*3% net return

In reviewing the comparison above, the monies available in a Captive for business use is almost twice as much in the Captive during the operating phase. Structured properly, these monies can be enhanced to a greater level. Our assumption in all the following examples are that the Captive is owned by an LLC which files as a "C" Corp.

#### EXAMPLE #1

**Dividend exclusion.** The dividend exclusion is an IRS rule that allows a proportion of all dividends received to be excluded from the calculation. On corporate income tax.....when a corporation owns 80% (reduced under recent legislation to 65%) or more of the business, it can deduct all of the dividend received.

Because our Captive files as a "C" corporation and our LLC files as a "C" corporation and the ownership is 100% the same, **a dividend can pass from the Captive to the controlling LLC tax free.**

The advantages of this ownership arrangement are that once the assets are transferred as a dividend to the holding company, those transferred assets are no longer subject to insurance regulations and have a broader investment opportunity than when controlled under a Captive Insurance Company.

The holding company can invest unencumbered....in mortgages, life insurance, purchase of businesses, especially those in the supply chain that affect the base profitability of the insured entity. This purchasing option permits the underlining business the opportunity to grow greater financial strength. There is no one more aware of the value of a business in its supply chain than the business that depends on its operation. This acquisition is an exceptional use and example of a business' ability to turn an expense (paying insurance premiums) into an enhanced profit program, improving financial security for the business enterprise rather than paying commercial rates for insurance with no return and then using retained capital as a funding vehicle.

#### EXAMPLE #2

Today, there are two major issues that are affecting the property & casualty insurance rates. The first is the fact that we are experiencing a **hard** insurance market and the second is the **lack** of insurance coverage.

A hard insurance market is defined as a period of time when insurance rates continue to increase. We have seen 10 quarters of increased rates and a reduction in available coverages. Some businesses have seen the cost of their coverage affected and to avoid these costs, business is self-insuring their coverages at a greater rate. This in turn can adversely affect a business in a time of claim. We have seen \$25 million umbrella policies now selling for the same price as the cost of a \$10 million policy. This is being exaggerated by the massive losses experienced by major companies as a result of the current pandemic. Losses are mounting and will be passed on to the consumers resulting in lower profits and decreased security. There is a crisis in today's marketplace that must be dealt with in a manner that allows business to continue to grow and not curtail investment back into the business because of this increasing line item. As the commercial insurance marketplace continues to raise rates, they are also curtailing the coverages being offered to the business community. Losses covered as a result of the coronavirus were denied by most commercial insurance companies. Depending on the coverage written within a Captive, many of these claims were handled in an orderly manner.

"The hardest part of this transition is not getting your business to change, the hardest part is adjusting your thought process and taking the steps to reimagine your risk and opportunities" ..... *J. W. Tucciarone.*



**Call Independent Captive Associates, LLC to learn more.**

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