# THE TEAM WITH THE BEST PLAYERS WINS……. Jack Welch

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## "There's No Place Like Home"

By William York, VP of Marketing

*"A man travels the world over in search of what he needs and returns home to find it" – George A. Moore*

When a captive insurance company is being incorporated, there are many places it can be formed. Historically, most captives were domiciled offshore in countries such as Bermuda or the Cayman Islands. This was due to the perception that there were certain tax benefits to being formed in those countries and that their legislative requirements were typically more friendly than onshore domiciles as it applied to solvency and initial capitalization requirements. Other potential advantages to domiciling offshore included the experience of these countries in the area of captive planning, established infrastructure for captives, financial flexibility, and cost savings. Over the past twenty years, these issues have changed significantly. Many US states have passed progressive laws that have made it much more attractive for a new captive to domicile and establish the captive at home.

Vermont was the first state to become active and competitive in the captive insurance company market. In the early 1980s, it passed laws that made domiciling a captive in that state very competitive with the popular offshore locales such as Bermuda and the Cayman Islands. Their motivation was clear – revenue. By aggressively competing for this business, the state could generate revenue that would be a meaningful addition to its fiscal bottom line. Since that time, Vermont has become the country's leader with 580 operating captives that generate close to $25 billion in annual premium with close to $200 billion in captive assets under management (as of 12/31/18). With many other states following suit (there are currently 28 states plus the District of Columbia with captive insurance companies), it becomes clear that there are some very compelling reasons for new captives to domicile in the United States and for existing captives to consider redomiciling onshore. Currently there are 3,000 active captive insurance companies domestically.

For tax purposes there is effectively very little difference between domiciling offshore or in the United States. Most captives make the election under Tax Code § 953(d) to be treated as a domestic company, thereby leveling the playing field. In addition, most states have limited the premium tax on "in-state" captives (captives that domicile in the state in which they are incorporated), thereby giving these companies a very good reason to domicile at home and creating a significant incentive for offshore owners to bring their captives back home. In terms of cost, since the competition between the states for domestic captives has grown, this has had a positive impact by lowering the costs of creating and operating a captive in the United States. At this point there is very little difference between the cost of forming and operating a captive insurance company onshore and offshore. Additionally, there is a convenience factor in operating a captive in the United States. While holding the required annual board meeting on a beach in the Cayman Islands sounds attractive, the reality is that it's much easier and more cost efficient to hold that meeting in your office's conference room or at the very least in a nearby state. The captives that are enjoying these changes the most are the small 831(b) captives with annual premiums of less than $2.3M. The competitive cost structure now available in the United States allows them to stay at home while at the same time keeping their expenses under control.

The driving reason for a captive insurance company to be domiciled in the United States may in fact be perception. While there are still many business owners and financial professionals who are skeptical about the concept of captives in general, there is no doubt that when the captive is domiciled in the United States there is a greater level of transparency. These companies must follow the laws of the state in which they are formed and disclose all their financial, actuarial, and claims information annually. In addition, owners must get state approval before taking any type of profit or distribution from the captive. This open dialogue with the state feels much more comfortable to many professionals than reporting operations from their activities in foreign countries that are notorious tax havens. In any potential examination by the Internal Revenue Service, if all operations of the captive insurance company were reviewed and approved by state regulators, the service may have a much harder time challenging the validity of the tax treatment for captives that have followed all of the domicile state's rules. The outlook for continued growth in the domestic captive market is bright. States are continuing to enter the market, encourage more flexible regulations, and promote in-state formation of new captive insurers.

While there still may be good reasons to domicile a captive insurance company offshore (allowable risk, financial structure, and privacy issues), these are becoming less prevalent and many captive owners are choosing to stay at home. As more states enter the market and others become more competitive, this is a trend that should continue for years to come.

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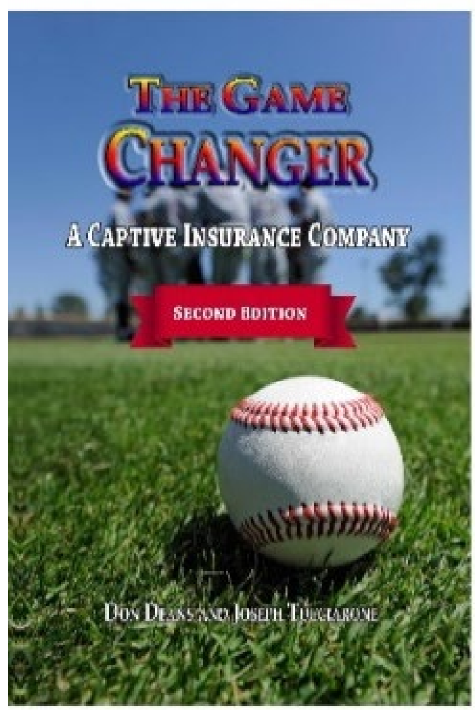


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