

# National Network of Accountants

RE-IMAGINING BUSINESS INSURANCE

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## SAFER AT HOME

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### Onshore/Offshore

One of the key decisions that prospective captive owners must make is whether to domicile their captive onshore or offshore. Onshore domiciles are jurisdictions located within United States that have enacted special legislation specifically designed to facilitate captive formations, while offshore domiciles are those jurisdictions outside the United States that also have such legislation.

### Safer at Home

The advantages of domiciling offshore were generally related to two issues – ease of operations and most importantly perception. Over the last twenty years this has changed and the same benefits are available onshore. In his *Made in America* tax plan, President Biden has declared *war* on US companies and taxpayers that utilize offshore *tax havens* to conduct business and avoid paying *their fair share* of taxes at home. This in and of itself should give domestic companies pause before domiciling their captives offshore.

However, there are other important reasons. Over the past twenty years, progressive US domiciles have *leveled the playing field* with their offshore competition by enacting captive regulations that lower capitalization requirements, ease regulations, reevaluate surplus requirements, and make captive operations more *business friendly*.

### In the Beginning

The first captive insurance companies were domiciled in Bermuda in the 1960s. Over the years other territories began welcoming captives as well. Originally, offshore domiciles offered very flexible regulations to this new and undeveloped insurance market. Flexible regulations were important at that time as captive managers and developers were still working out the logistics of forming and operating captives. It gave them opportunities to discover the best ways to run these businesses without having to deal with onerous regulatory scrutiny.

### The Present

Now that the captive industry is well-established both in the United States and abroad, many of the original benefits that offshore domiciles offered have been reduced if not eliminated. In recent years, as onshore domiciles have become sophisticated and flexible in their operations, the reasons for captives domiciling offshore has diminished. With the advent of more states adopting captive legislation, regulators have had to become more educated, knowledgeable, and savvy in the regulation of captive insurance companies. Domiciles that are dedicated to bringing captive business to their region are keeping their captive laws up to date to meet the needs of new captives, while continuing to regulate them responsibly. In addition, recent economic challenges, due to the COVID-19 pandemic, have made it incumbent upon states to significantly raise revenue. By attracting new captive formations and incentivizing existing

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captives to redomicile to their state, these domiciles see captives as one way to help address their budgetary concerns and encourage economic development. Premium taxes, economic activity by service providers, and other benefits that captives bring are enjoyed by the domicile as captive growth increases.

For example, the State of Connecticut realized these issues and made a strong commitment to grow its captive business. In 2020, Connecticut led the country with a 38% increase in captive formations. This was primarily due to a yearlong initiative to educate businesses and their professional advisors of the benefits surrounding captive insurance to boost the state's profile as an *up-and-coming* captive domicile.

When considering taxation, offshore domiciles generally do not levy premium taxes on captive insurance companies. Historically, this was one of the benefits of forming a captive offshore. However, in these situations offshore captives become a *non-admitted insured* in the state where the risks are located (primarily the home state of the parent company). Most states have regulations that seek to charge a *self-procurement tax* on premiums written by non-admitted insureds. Self-procurement taxes range from 2% – 6% of premiums, depending upon the regulations of the state. These taxes can be viewed as *retaliatory taxes* since the state is not collecting direct premium taxes from the non-admitted insured. These taxes are designed to encourage and incentivize companies to domicile captives in their home state and not offshore (or even in another US state of domicile). While there is some disagreement and litigation as to the proper application of self-procurement taxes, it is clear that states are moving to collect such taxes to which they believe they are entitled. By avoiding offshore domiciles, US based companies can eliminate the self-procurement tax question, avoid facing potential back taxes and penalties, and not have to worry about future state tax collection actions.

Another important consideration is that there is generally more transparency in US based domiciles as it applies to regulation and oversight than in offshore locales. This is more important now than ever given the Biden Administration's aggressive pursuit of offshore funds and plans to scrutinize companies and their owners who transact business in notorious *offshore tax havens*. More transparency in captive transactions does nothing but enhance the perception of the legitimacy of

captives in the financial sector and encourage favorable legislative and tax treatment.

## Summation

**The outlook for US based domiciles has never been brighter.** New domiciles entering the domestic market are compelled to be competitive in what they offer for both new and established captives. This in turn encourages all captive domiciles to adjust and improve their own laws in order to stay ahead of the competition. Captive insurance companies now have a much broader selection to choose from and the ability to pick the domicile that can best serve their individual needs. Twenty years ago, there were few viable onshore choices, and the expertise was dominated by offshore locations. It is clear that things have changed. Many onshore domiciles have adopted a much more *business friendly environment* and have made an active effort to regulate captives in a way that accommodates the needs of the underlying businesses, thereby creating the desire to form a captive offshore less attractive. While the offshore locations are still a great place to have a board meeting on the beach once a year, it is clear that a compelling case can be made for domiciling a captive onshore now more than ever.



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