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THE KEY TO “SOUND” INSURANCE

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One of the greatest challenges that all businesses face is the ability to build sufficient liquid reserves that ensure their security. Liquid assets have always been the key to the long-term health and survival of a business. **Being in a strong cash position is particularly important if an unforeseen calamity strikes.** Liquidity enables a business to quickly adapt or pivot in order to address changes in the marketplace. Today, this is of utmost importance.

Our experience has revealed time-proven destroyers of liquid reserves:

Let's consider an issue often overlooked -- taxes on “excess” retained earnings, known as the **Accumulated Earnings Tax**. **This tax is deliberately designed to discourage businesses from building up wealth and liquidity.** The Accumulated Earnings Tax (AET) is a

penalty tax, imposed on C Corporations, perceived as trying to avoid or defer shareholder income tax through an “unnecessary” accumulation of earnings. There is no agreed upon test to define when a C Corporation is purposely avoiding income tax or what is an impermissible accumulation of earnings. An IRS agent asserts that there is an excess accumulation of earnings and the burden of proof shifts to the taxpayer to defend.

Today, business owners face far greater challenges. In fact, they are more likely to face existential threats that can drain their limited cash reserves or completely wipe out their operations. For instance, cyber risk is a growing and wildly unpredictable threat. Terrorism and impact from international conflicts are very real threats to businesses and their operations. (Even if a business isn't directly targeted, how long can cash reserves last without power...without infrastructure...without key suppliers...without key customers?)

Consider “Human-caused hazards [like] terrorism.” Ready.Gov makes it clear that any business in the U.S. could be impacted by terrorism. Businesses should have business interruption insurance for lost revenue caused by terrorism including chemical, biological or nuclear attack. Businesses should also be insured for business interruption caused by failure of the power grid (due to natural disaster, terror attack or a solar storm). The recent pandemic is an example of the need for “business interruption” insurance as well as the status of peace in our world currently.

In addition to the existential threats covered above which can quickly empty business coffers, mid-size business owners face risks posed by their own governments – local, state and federal. Government regulators wield more power than in bygone days. Overzealous government regulators often “shoot

first and ask questions later.” They often have the power to shut down a business until a dispute can be resolved by the courts.

Finally, litigation is an ever-increasing threat to business owners and their liquidity. The dangers come from inside and outside of their businesses. Business owners and their staffs must navigate a complex maze of employment laws, healthcare laws, worker’s compensation laws, environmental laws, tax laws and many other laws that can result in costly lawsuits. Also, many commercial insurance liability policies will cover damages, but do not cover punitive damages awarded in a lawsuit. In many cases, punitive damages awarded to plaintiffs are 3 to 10 times higher than compensatory damages.

The “Captive Option” can address the liquidity threats outlined above by supplementing commercial insurance coverage with insurance coverage provided by the CAPTIVE.

The “Captive Option” is one of the most powerful risk management and wealth accumulation tools that a business can access. When properly employed, there is nothing else that can do what a captive insurance company can do.

A Captive Insurance Company can issue insurance policies that address gaps not covered by third party insurers. Captives can also insure third party insurance deductibles, enabling the parent company to raise its deductible and lower its third-party insurance costs. Also, a business can enjoy more broad business interruption coverage with a Captive when an adverse event occurs, particularly events where third-party insurance doesn’t cover all damages or peripheral damages.

Captive Insurance Companies can write customizable coverage for the businesses they insure. Many businesses face unique risks that may not be addressed by commercial insurers. Unique coverages can also be very expensive when covered by commercial insurers. This feature enables business owners to say, “this has gone wrong in the past, let’s insure against it in the future,” or “other companies have experienced this

adverse event, we can insure this via our captive.” **The flexibility afforded with a captive is extremely beneficial in this complex world.**

Premiums paid to a captive insurance company remain the property of the captive owners.

Premiums paid to a captive receive favorable tax treatment. Premiums paid to the captive are an expense to the parent company. **This lowers the parent company’s** taxable income. As, the captive takes in premiums, it is taxed as an insurance company on its underwriting profits (typically defined as premiums less reserves to pay future claims). For large insurance companies, underwriting profit is actuarially determined. However, small insurance companies can make an 831 (b) tax election, resulting in a tax rate of 0% (that’s zero percent) on their underwriting profit. A small insurance company is defined as receiving premiums of \$2.2 million or less per year.

A captive is able to invest and grow its pool of assets to grow an even larger pool of assets.

For these reasons, a well-run, captive insurance company will typically double liquid capital.

A Captive Insurance Company is clearly the most powerful approach for a business to improve risk management and simultaneously stock pile assets. With so many benefits, it is easy to see why more than 50% (and growing) of all insurance coverage by business paid today is in the captive insurance marketplace and not the commercial insurance marketplace.

Call for more information on Captive Insurance or to schedule a meeting.



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