AFFORDABLE CAPTIVE INSURANCE FOR THE SUCCESSFUL BUSINESS OWNER
For Successful Businessmen & Professionals

Are you aware that within the Internal Revenue Code there is a provision that allows successful business owners to own their own insurance company which is called a Captive Insurance Company (Captive)?

- The reason it is called a Captive is because the owner of the business owns it, writes the premium checks for risks he controls, files the claims and therefore can manage the underwriting profits.
What is a Captive Insurance or Reinsurance Company?

IRC Section 831(b) allows a captive to be taxed as a small company (Small Insurance Company Tax Election). Under the 831(b) election, if the total gross premiums of the insurance company are $1.2 million or less annually, the company will only be taxed on its investment income. Since the 831(b) company does NOT pay tax on its underwriting profits, its reserves can grow faster tax-deferred.
What Basis is a Captive Reinsurance Company Formed?

With Proper Risk Distribution and management all Captive types are compliant.

**IRC Section 162** allows insurance premium payments to be deducted as an ordinary and necessary business expense.
Captive Industry Facts

Did You Know That:

Over 30 of the U.S. States and many jurisdictions worldwide have captive legislation compliant to the U.S. tax code.

There are Over 5,617 captives worldwide.

Captives represent 20% of the world’s P&C insurance.*

Captives account for over 10% of all insurance premiums collected worldwide*

All 30 Dow Industrial Companies and over 80% of the S&P 500 own Captives*

Captives Represent Almost $60 Billion in premiums worldwide!*

1. Business Insurance, March 2011  * Captive Insurance Company Reports and Marsh Survey Group
IRC Section 953(d) a foreign domiciled captive reinsurance company (CRC) can receive the same US tax benefits and treatment as one formed in any of the US states that have captive legislation. Therefore, a captive reinsurance company that is formed, licensed, managed and operated outside the US can make an IRC section 953(d) election to be taxed as a domestic C corporation for US tax purposes. This election allows foreign insurers to avoid exposure to branch profit taxes and the Section 4371 excise tax on premiums.
Why Businesses Use A Captive:

**Hidden Risks:** exist within all businesses and are best addressed through an alternative risk-financing program, rather than purchasing traditional insurance or by simply absorbing these risks as they arise.

**Tax Benefits:** Insured’s come to understand a basic tenet of insurance, that risks inherent in their business are capable of being **insured with tax-deductible premium dollars** that will be available to satisfy future losses.

**Pre-Funding:** Insured’s learn and benefit by significant tax advantages that exist in **pre-funding** losses through a captive reinsurance company.
Why A Captive
(continued)

**Reduced Insurance Costs:** By eliminating the infrastructure costs of big insurance companies, your captive can capture underwriting profits you were giving away.

**Asset Protection:** A properly structured Captive offers significant asset protection benefits for their affiliated insured and owners.

**Wealth Accumulation:** Captives can be owned in family trusts for estate planning strategies; they can fund a Buy/Sell Agreement, or be used for recruiting and retaining key employees.
Sample Risk Coverage:

- Computer Hardware
- Employment Practices
- Cyber Risk
- Excess Professional Liability Legal/Claim Expense
- Inventory Obsolescence
- Loss of Key Supplier
- Loss of Hospital Privileges (Doctors Only)
- Regulatory Changes
- Tax Audit Defense Legal Expense Reimbursement
- Work Stoppage
- Terrorism
- Franchise Legal Defense Costs
- High Deductable Medical Insurance
- Regulatory Investigation Defense Legal Expense
- Tax Liability
- Tennant Discrimination, Harassment & Wrongful Eviction
- Trade Credit
- Transportation Damages
Sample Risk Coverage:

- Commercial Pollution
- Commercial Property Plus
- Disability Income
- Crime/Employee Dishonesty
- Errors & Omissions
- **Loss of Key Customer**
- Loss of Patient Referrals (Doctors Only)
- Excess Professional Liability Loss Reimbursement
- Injunctive Relief Defense Legal Expense Reimbursement
- **Work Stoppage**
- Franchise Legal Defense Costs
- High Deductable Medical Insurance
- Regulatory Investigation Defense Legal Expense Reimbursement
- Market/COGS Fluctuation Loss Expense Reimbursement
- International Kidnap/Ransom Investigation
- Warranty
- Warranty Shortfall
Advanced Planning Opportunities:

- Estate Planning Benefits, **wealth maximizing**
- Asset Protection Strategies, **wealth protection**
- Key Man Planning, **wealth control**
- Business Succession Strategies, **wealth succession**
INTERNATIONAL or DOMESTIC CRC OR CAPTIVE SEGMENT

PROPER PREMIUM USAGE AND EXAMPLE OF RISK COVERAGE

Company

100% of Tax Deducted Premium

Madison National Insurance Ltd. Independent Insurance Company
Domicle: Turks & Caicos (TCI)
(FRONTING CARRIERS)
SEE NOTE BELOW

Insurance Policies

40% of the premium is retained by the fronting carrier for 50% of the risk and pooled to cover all insured’s risk and to insure proper risk shifting.

Examples of Risk Coverage Types

- Tax Audit
- Legal Expense Reimbursement
- Employment Practices
- High Deductible Medical Insurance
- Loss of Key Clients
- Loss of State License
- Regulatory Investigation
- Cyber Risk
- Excess Professional Liability Loss Reimbursement
- Directors and Officers
- Terrorism Damage

60% of the premium, less expenses, is ceded to the Domestic/International Captive Reinsurance Company or the Segregated Segment Slot to cover the risk or liability.

Domestic/International Company
IRC 831(b) election
U.S. 953(d) election

Domestic/International Segregated Segment Slot* IRC 831(b) election
U.S. 953(d) election

NOTE:
IRS PLR’s 200950016 & 200950017 discuss the use of one or more Fronting Companies, which is our conservative model using a Fronting Company.

* A Segmented Segregated Slot is a shareholder of the parent captive reinsurance company.

Disclaimer: Operating cost will be deducted before the premiums are ceded.
### Basic Economic Overview

**Start-Up Expense Breakdown For a $1.2 Million Captive:** (FIRST YEAR ONLY EXPENSE)

<table>
<thead>
<tr>
<th>Description</th>
<th>1st Year</th>
<th>2nd Year</th>
<th>3rd Year</th>
<th>4th Year</th>
<th>5th Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Assessment Documentation &amp; Consulting Expense</td>
<td></td>
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<tr>
<td>Actuarial Rate certification</td>
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<td></td>
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<tr>
<td>Captive Formation Reimbursement</td>
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<tr>
<td>Total</td>
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**Note:** Set-Up expenses for smaller premiums are pro-rated at $1,275/$100,000. i.e. $200,000 premium costs $11,500

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**Estimated Gross Premium**

<table>
<thead>
<tr>
<th>Year</th>
<th>1st Year</th>
<th>2nd Year</th>
<th>3rd Year</th>
<th>4th Year</th>
<th>5th Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st Year</td>
<td>200,000</td>
<td>210,000</td>
<td>220,500</td>
<td>231,525</td>
<td>243,101</td>
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<tr>
<td>2nd Year</td>
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<tr>
<td>3rd Year</td>
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<td>4th Year</td>
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<td>5th Year</td>
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</tbody>
</table>

**Estimated Tax Savings Federal, State & Misc. (43.9% SAVINGS)**

<table>
<thead>
<tr>
<th>Year</th>
<th>1st Year</th>
<th>2nd Year</th>
<th>3rd Year</th>
<th>4th Year</th>
<th>5th Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st Year</td>
<td>87,800</td>
<td>92,190</td>
<td>96,800</td>
<td>101,639</td>
<td>106,721</td>
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<tr>
<td>2nd Year</td>
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<td>3rd Year</td>
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<td>5th Year</td>
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</tbody>
</table>

**Estimated Operating Expenses, Including Annual Renewal & Set-Up Costs**

<table>
<thead>
<tr>
<th>Year</th>
<th>1st Year</th>
<th>2nd Year</th>
<th>3rd Year</th>
<th>4th Year</th>
<th>5th Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st Year</td>
<td>34,500</td>
<td>26,700</td>
<td>27,908</td>
<td>29,175</td>
<td>30,507</td>
</tr>
<tr>
<td>2nd Year</td>
<td></td>
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<tr>
<td>3rd Year</td>
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<td>4th Year</td>
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<td>5th Year</td>
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</tbody>
</table>

**Estimated Cumulative Premium Surplus Combined with Capital & Tax Savings**

<table>
<thead>
<tr>
<th>Year</th>
<th>1st Year</th>
<th>2nd Year</th>
<th>3rd Year</th>
<th>4th Year</th>
<th>5th Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st Year</td>
<td>205,500</td>
<td>388,800</td>
<td>581,393</td>
<td>783,742</td>
<td>996,337</td>
</tr>
<tr>
<td>2nd Year</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>3rd Year</td>
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<tr>
<td>4th Year</td>
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<td>5th Year</td>
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</tr>
</tbody>
</table>

**Beginning Surplus Capital**

<table>
<thead>
<tr>
<th>Year</th>
<th>1st Year</th>
<th>2nd Year</th>
<th>3rd Year</th>
<th>4th Year</th>
<th>5th Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st Year</td>
<td>40,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2nd Year</td>
<td></td>
<td></td>
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<tr>
<td>3rd Year</td>
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<td>4th Year</td>
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<tr>
<td>5th Year</td>
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</tr>
</tbody>
</table>

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**Note:** The above charts and summaries are examples and do not show any claims or claims expenses and these examples would be adjusted accordingly pertaining to any claims filed and any expenses or indemnity payments made. These examples also do not show any consideration for investment income, and taxes against such income.
## Financial Comparison:

<table>
<thead>
<tr>
<th>Operating Company</th>
<th>Self Insured without a Captive</th>
<th>Self Insured with a Captive</th>
<th>First Year ONLY Entry Expenses:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Operating Company</td>
<td>Premium to a Captive</td>
<td>$1,495 Feasibility Study</td>
</tr>
<tr>
<td></td>
<td>$200,000</td>
<td>$200,000</td>
<td>$5,750/$100,000 for Initial Set-Up</td>
</tr>
<tr>
<td></td>
<td>44% Tax rate (fed &amp; state)</td>
<td>Less expenses</td>
<td>i.e. $200,000 = $1,495 + $11,500</td>
</tr>
<tr>
<td></td>
<td>-$88,000</td>
<td>(23,000)</td>
<td>Set-Up or $12,995</td>
</tr>
<tr>
<td></td>
<td>After tax profit</td>
<td>Net before claims and</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$112,000</td>
<td>investment income</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Investment income</td>
<td>$177,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>( at 5% less tax )</td>
<td>Investment income</td>
<td>$5,045</td>
</tr>
<tr>
<td></td>
<td>$3,249</td>
<td>( at 5% less tax )</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Net after one year **</td>
<td>$182,045*</td>
<td>($53,801 Difference First Year)</td>
</tr>
<tr>
<td></td>
<td>$115,249</td>
<td>$12,995</td>
<td>($121,781 Difference 2nd Year)</td>
</tr>
</tbody>
</table>

** - Net reflects amount prior to payment of claims, if any.

Note: This is a hypothetical illustration and does not represent an actual investment. There is no guarantee similar results can be achieved. If investment fees had been reflected, the return would have been less.

### 10 Years Later:

<table>
<thead>
<tr>
<th>Operating Company</th>
<th>Self Insured without a Captive</th>
<th>Self Insured with a Captive</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Approximately: $1,196,000</td>
<td>Approximately: $1,852,000*</td>
</tr>
</tbody>
</table>

** POTENTIAL DIFFERENCE: $656,000

* - Net after ten years reflects an approximate amount prior to payment of claims, if any.
Our Strategic Partner is Captive Alternatives, LLC. A Business Solution Consulting Group

- Captive Alternatives, LLC is an International Consulting Organization and their Underlying Strategic Team has been in the Captive Consulting Business Since 1986.
- Specialize in international and/or Domestic Captive Reinsurance Strategies, Risk Pooling & Surplus & Captive Management Oversight.
- Consulted For over 100 Captive Structures
- Utilize Flexible “Best of Breed” Methodology to Customize Support Services
- Use Only Acceptable Risk Shifting Models as Outlined in IRS PLR’s 200950016 & 200950017
- Provides an Affordably Priced Captive Structure for ALL Sized Businesses.
- Never experienced a change in any IRS audit.
Providing a Turn-Key Service From Design to Implementation to On-going Compliance
NEXT STEPS
Complete a Risk Assessment and Feasibility Study Request

We need the following to get started:
1. Tax returns filed for the preceding two years
2. A brief profile of the business
3. A completed Risk Assessment Questionnaire.

**NOTE:** You will receive a thorough Feasibility Review covering: Objectives, Problem Identification, Premium Summary, Risk Financing, Tax Considerations, Domicile Review, Capitalization, Required Risk Sharing & Distribution and a Power Point Presentation providing a step by step understanding of the captive, risk pooling, flow of funds, initial start up costs, annual expenses, projected benefits, etc. will be presented.
Captive Insurance Companies (CIC) can be the most powerful risk-mitigation/wealth-building tools available to profitable business owners. Until recently, CICs were so expensive that most businesses simply could not justify using them. With the advent of the Affordable Captives Solution, CICs are now a viable tool for most profitable businesses.

www.affordablecaptives.com
What is a Captive Insurance Company (CIC)

A CIC is an insurance company established to insure the risks of its parent company or a group of companies. In the simplest form, a CIC is an organized plan of self-insurance that calculates risk, issues policies, collects premiums, pays expenses, and establishes reserves to pay future claims.

Self-Insuring Risk

Every business chooses to self-insure multiple risks that could be covered by commercial insurance. Some examples of these risks are: loss of license for professionals (doctors, lawyers, CPAs, financial planners, etc.), loss of key supplier, legal defense, or audit defense liabilities. If a business that is not insured incurs a loss because of one of the aforementioned risks, the business can sustain sometimes substantial financial loss as a consequence.

Why are captives formed?

Several reasons which include but are not limited to: 1) to protect against uninsured risks not covered by traditional insurance; 2) to control risk by setting coverage desired by the business owner; 3) greater control over claims; 4) reduce total insurance costs; 5) income tax planning; 6) wealth building; 7) estate planning; 8) asset protection.

Are CICs commonly used tools?

Yes. Over 75% of the Fortune 500 companies have CICs.

Why aren’t more businesses using CICs?

In a word: Costs! Until the creation of the Affordable Captive structure, businesses needed to commit to paying annual premiums of $500,000 or more a year to make them financially viable.

What is the minimum premium to use the Affordable Captive structure?

$100,000 a year.
What tax code section is used as the basis to form a CIC?

28 U.S.C. sec. 831(b). 831(b) CICs are considered “small captives.” There are other tax code sections that govern other types of CICs, but most medium-to-small businesses will use code section 831(b) when forming a CIC.

Are premiums paid to a CIC deductible?

Yes. 100% deductible by a business as an ordinary and necessary business expense.

How are premiums received by the CIC taxed as well as investment growth on reserves as they grow?

Premiums are 100% tax free when received by a CIC. Investment growth inside the CIC is taxed at the C-Corporation tax rate.

How do you mitigate the taxes levied on reserves as they grow in the CIC?

The CIC owner can have the reserves allocated to tax-free bonds, tax-efficient brokerage accounts, or cash value life insurance.

What happens after years of funding a CIC when an owner decides it is no longer needed?

It depends on the structure. With a one-owner CIC, it can be closed down (at which time under the current state of the law the owner would pay long-term capital gains taxes on the above-basis assets of the CIC). With a multiple-owner CIC, when one owner wants to end his ownership in the structure, his/her interest is redeemed; and the above-basis assets will be taxed at the long-term capital gain tax rate.

How much does it cost to set up a typical CIC?

$50,000-$75,000 for a single-owner captive.

How much is the cost for the Affordable CIC structure?

$5,750 per each $100,000 premium. If premiums of one owner exceed $800,000, the setup costs are capped at $46,850 for an international CIC and $58,850 for a domestic CIC.

What is the typical annual administration fee for a CIC?

$35,000-$50,000 a year for structures that have flat fees. For CICs that charge fees on a percentage of new premiums, the fee is 14-18% of each year’s premium.

What is the annual administration fee for the Affordable CIC structure?

11-12% of new premium.
Why are costs for affordable CIC structures so much less?

Two reasons: 1) Economies of scale. Each 831(b) CIC will be set up to maximize the allowable premium at $1.2 million a year. Most CICs have annual premiums starting at $400,000 a year. Because single-owner CIC administrators are working off of premium amounts that are typically between $400,000-$600,000 (vs. $1.2 million), they keep a higher fee structure to have an economically viable structure. 2) Many CIC administrators keep their fees high because that’s what the market will bear. CICs done right are such good risk-management/wealth-building tools that business owners will pay fees up to 18% of new premiums for their structures. To put it bluntly, there are not many firms in the CIC administration business; and they know it (and have chosen to keep fees higher than are needed to put forth a price-reasonable model for the CIC administrator and CIC owner). It is because of reason number two that the Affordable CIC solution was created.

Does a CIC bear 100% of the risk for the insurance coverage it provides?

No. CICs have a requirement to share its risk with others. Conservatively structured CICs share 50% or more of their risk with other similarly structured CICs. CICs are real live insurance companies that issue policies to policyholders who can have claims. A good CIC structure will risk share with a large risk pool to spread the risk among other CICs.

What is the average claims history of a typical CIC?

It varies greatly depending on the risks insured. CICs that insure non-traditional risks (traditional being auto, homeowners, E&O coverage) typically have a claims history of less than 10% a year and many of less than 5%. The bigger the risk pool the lower the risk exposure.

Where should CICs be formed?

It depends on what’s important to the CIC owner(s). CICs have traditionally been set up in non-domestic jurisdictions like the BVI (British Virgin Islands) to have maximum asset protection and to minimize capitalization. Now, in excess of 25 states have enacted CIC legislation allowing them to be formed domestically.

Who has control of the money in a CIC?

Captive owners control their company, how claims are handled, and how reserves or underwriting profits are invested. Accounts are set up so that the CIC owner has total control of the money.

How long have CICs been around?

Since the 1960s.

Why have you not heard of CICs before?

Because of the high premium amounts for traditional single-owner CICs ($500,000+ a year), few advisors choose to take the time to learn about them. Large CPA and law firms are typically aware of CICs because they deal with larger clients who can economically justify using them. Now with the Affordable Captive structure, more advisors will learn about them; and, in turn, more consumers will learn about them.
Is the Affordable CIC structure a segregated-cell captive?
No. It is a traditional Section 831(b) non-segregated cell CIC.

What are the capitalization requirements to set up the Affordable CIC?
$20,000 per $100,000 of first year premium for internationally based CICs and $25,000 per $100,000 of first year premium for domestically based CICs.

What is a feasibility study, do you need one, and what do they typically cost?
A feasibility study is done by a CIC manager to determine if a business that wants to use a CIC is a good fit. It is a thorough review of the last two years tax returns combined with analyzing the risks of the business owner. This includes a preliminary determination of the types of risks that can be insured and whether the company has sufficient risk to pay premiums in the amount desired. A feasibility study is done by every quality CIC manager before taking on a client. The cost will vary depending on the administrator, type of CIC, and the types of risks being insured. Costs typically range from $10,000-$50,000+.

What is the cost of a feasibility study for the affordable CIC structure?
$1,495. This is a one-time, non-reimbursed fee.

Who is involved in the setup/formation/ongoing administration of a CIC?
Actuaries—one of the keys to having a successful and respected CIC is the use of a good actuary. Too many times will fly-by-night CIC managers use actuaries that do not use sound principles when determining the viable risks to insure and the fair market value of the cost to insure such risks.

Attorneys—law firms are part of the setup process of a CIC structure. This includes the CIC itself as well as other structures (such as a domestic or international LLC to own the interest of the CIC).

Accountants/auditors—tax returns must be filed appropriately, and a business typically has a local CPA who will want to review the structure from the outset to make sure it is being done properly.

Managers—you cannot have a compliant or well-run CIC without a good manager. A manager helps coordinate all the other advisors to help set up (licensing, etc.) and run the CIC on a day-to-day basis. This includes dealing with the risk-sharing pool and claims.

Other consultants—many times a CIC will have a financial advisor or insurance agent involved in the structure to give counsel as to how and where capital and reserves should be positioned to grow wealth in the CIC in a protected and tax-favorable manner.

Who typically owns the CIC?
For enhanced asset protection reasons, ownership of a CIC is typically a domestic limited liability company (LLC), international LLC, or offshore asset protection trust. For owners who have estate tax problems, the CICs interest is typically owned by an irrevocable trust.
If you own or run a profitable small-to-medium sized business, the question is: **Can you afford to pass up the benefits** of using the Affordable Captive Insurance Company Structure?

The benefits of the Affordable Captives structure:

- **Risk Management**: CICs are formed to reduce risk. When buying traditional insurance coverage, there is no incentive to mitigate covered risks. Because a CIC is owned by the business or business owners, there is a financial incentive that will motivate a business to improve its risk-management program.

- **Controlling Insurance Costs**: When using a CIC to provide insurance coverage, businesses are in control of the insurance costs, size of deductibles, types of coverage provided, the claims process, etc.

- **Expanding Insurance Coverage**: There are dozens of insurance risks that most businesses choose to self-insure against. Defense costs and claims for uninsured risks are paid out of the cash flow of a business. With a CIC, businesses can now purchase insurance coverage for several uninsured risks and protect the financial viability of the business in the event of one or multiple claims.

- **Wealth Building**: CICs are funded with pre-tax premium payments. With a reasonable claims history, CICs can accumulate substantial assets in a tax-favorable structure. If wholly or partially owned by an irrevocable trust, CICs can also offer tremendous estate-planning benefits.
Harnessing the Power of the Affordable Captive Insurance Company Structure

How can business owners harness the power of the Affordable CIC structure?

A good starting point is to learn more about CICs by going to www.AffordableCaptives.com.

At our web site, you can learn the basics about CICs and more specifics about the Affordable CIC structure.

Find a local advisor

If you would like to speak with a local advisor about the Affordable CIC structure to determine if your business can benefit by using this unique risk-management/wealth-building tool, please e-mail info@AffordableCaptives.com

General inquiries

If you have questions about the Affordable CIC, please e-mail info@AffordableCaptives.com.
Dear Mr. Client:

Per your request, this is a brief summary of the potential financial opportunity that might be available to you through the use of an affordable Captive. This is a simple estimate based on very limited data; Our strategic partner, Captive Alternatives and their CPAs and actuarial company would base all final figures on a review of your actual tax returns and a better understanding of the risk areas in need of coverage (please see the Feasibility Study Request Form). This will only address the financial side of the opportunity and will not address the other potential benefits such as how the captive might be used for estate planning, asset protection, etc.

As we know, the IRS has established the opportunity for a small business owner to own his own reinsurance company and pay premiums from $100,000 up to $1.2 million to his own insurance structure. Since many CPAs are not familiar with the applicable code sections, I have attached them for their review. The purpose of a captive must be to insure against those risks particular to the owners and their business. To be compliant, the premiums must be actuarially derived by a third party independent firm and there must be shared risk or what is commonly referred to as a “risk pool”. This structure is also referred to as a captive reinsurance company, since it is owned by the business owner, who pays the premiums and files the claims; typically against areas of risks that he/she controls. These are risks that most business owners are currently covering from their cash flow as they arise. Examples are loss of operating rights in a hospital for a doctor and/or medical professional; legal tax audit defense reimbursement (in case the business is audited, funds are available to pay the CPA/attorney, etc); loss of key supplier or key customer, etc. Please see below “Description of Coverage Areas”.

I understand the revenues are approximately 2.5+ million plus and there are two owners and they have a budget of approximately $400,000 for risk premium. The actual amount of premium acceptable to the IRS will be determined through a feasibility review of your tax returns and other requested information. Therefore, we will use $400,000 as the premium for the purpose of this example. Under IRC section 162, this payment would be deductible as an ordinary and necessary business expense.

Versus withdrawing $400,000 as income and ending up with approximately $250,000 after “all” their taxes, suppose we implement a captive and instead chose to pay $400,000 as a captive premium. The first year, after “all” costs, they would end up with underwriting profits of approximately $330,000 (an $80,000 gain) less claims, if any. Each subsequent year, after all captive expenses, they would have approximately $356,000 of underwriting profits, less claims or a difference would of approximately $106,000 of additional income not otherwise available to you; less claims. These profits are in a tax favored environment and are yours to invest as normal subject to being liquid and the reserve fund. No taxation applies to the underwriting profits until years later when the captive is closed and they are withdrawn as dividends; c-corp. rates apply only to the investment gains derived from the investments of these profits. The captive can be used as a wealth transfer vehicle, for estate planning purposes, can own life insurance, etc.

Our conglomerate of companies has been designing, implementing maintaining compliant captive structures since 1987. We implement them domestically or internationally depending upon the needs and objectives of the client. In our history our clients have incurred about 30 audits without any changes! Our work brings about significant benefits but done in a conservative manner.

The purpose of this letter is solely as educational information. If you would like to consider a captive for your business, then we would welcome the opportunity to work with you and your advisors.
DESCRIPTION OF COVERAGES

Please note that the descriptions below are basic summaries of the insurance protection available and do not supersede the actual insurance policy and endorsement language for such insurance protection. Please refer to the insurance policy and endorsements for all terms and conditions of the insurance protection selected.

1. Commercial Pollution: Provides coverage for clean-up costs resulting from pollution escaping into the environment or buildings.

2. Commercial Property Plus: Provides coverage for any direct or indirect loss of property owned or under control of insured where loss is excluded from all other policies of insurance which policy holder has. In addition, insurance company will cover the deductible of ANY loss under another policy, provided that deductible exceeds 10,000 dollars (loss is not restricted to commercial property).

3. Computer Hardware: Provides coverage for any losses sustained by the named individual insured's company resulting from a computer malfunction or misuse of information on computers by an employee of insured. Coverage is provided for all expenses related to the elimination of computer viruses, data recovery, and loss of income related to the event.

4. Crime/Employee Dishonesty: Provides criminal defense legal expense reimbursement to the named individual insured's company for criminal matters and allegations against the insured's company.

5. Cyber Risk: Provides coverage for costs of data recovery and eliminating computer viruses. Also, coverage is provided for all expenses related to extortion by an individual with plans to damage software or data, expenses related to copyright and trademark infringement as a result of improper content on Insured's website, and loss of income for related event.

6. Disability Income: Provides total disability insurance protection for the named individual insured.

7. Employment Practices: Provides coverage for any loss resulting from a wrongful act. A wrongful act includes any actual or alleged:
   • Termination of an employment relationship in a way that is against the law and wrongful. Wrongful demotion, failure to hire, retaliation, misrepresentation, and interference of contract, which arise from a decision to employ, terminate, evaluate, discipline, promote or demote.
   • Defamation, infliction of emotional distress or mental anguish, humiliation, false imprisonment, invasion of privacy and other personal injury allegations which arise from the terminating, disciplining, promoting or demoting of an employee.
   • Breach of an implied employment contract and breach of the covenant of good faith and fair dealing in the employment contract.
   • Discrimination, harassment, retaliation or any actual or alleged response of the insured to a threat made by an employee to disclose an illegal act by insured.

8. Errors and Omissions: Provides coverage for errors or omissions in the insured’s performance of services. Services are defined as activities undertaken by the insured for a client in relation to the following:
   • legal and tax services as they relate to proper formation and operation of an insurance company
   • accounting or tax preparation services in regard to insurance activities
   • any other activity permitted by law and authorized by the board of directors of an insurance entity
9. **Franchise Legal Defense Costs**: Provides coverage for legal costs associated with loss or adverse amendment to a Franchise agreement. For witnesses attending court, company will provide compensation in the amount of 500 dollars per person per day.

10. **Injunctive Relief Defense Legal Expense Reimbursement**: Provides injunctive relief defense legal expense reimbursement to the named individual insured's company for injunctive relief actions against the insured's company.

11. **Inventory Obsolescence**: Provides coverage for the costs of products that cannot be returned to the supplier and have not been sold in the last 24 months by the insured.

12. **International Kidnap/Ransom Investigation**: Provides kidnap/ransom investigation expense protection to the named individual insured’s company in the event the named individual insured is kidnapped while traveling abroad.

13. **International Travel Disability**: Provides disability insurance protection for the named individual insured while traveling abroad.

14. **International Travel Medical Expense Reimbursement**: Provides higher limits of health insurance protection while traveling abroad for the named individual insured.

15. **Loss of Hospital Privileges**: Provides reimbursement of expenses due to the involuntary discontinuation of medical staff membership or involuntary reduction in approved medical procedures at a hospital.

16. **Loss of Patient Referrals**: Provides reimbursement of expenses due to the loss of a key supplier of patient referrals to the named individual insured's company.

17. **Loss of Key Customer**: Provides reimbursement of expenses due to the loss of a key customer to the named individual insured's company.

18. **Loss of Key Supplier**: Provides reimbursement of expenses due to the loss of a key supplier to the named individual insured's company.

19. **Market/COGS Fluctuation Loss Expense Reimbursement**: Provides reimbursement of expenses due to the financial losses to the named individual insured’s company due to market/cost of goods sold cost fluctuations that exceed a specified percentage amount.

20. **Regulatory Changes**: Provides coverage for any business interruption loss for 12 months as a result of a regulatory change that has an adverse effect on business. Regulatory changes include:
   - any legislative changes effecting permits
   - issuing of permits to competitors
   - any changes to environmental, zoning, transportation or safety regulations
   - any changes to import/export laws or tariffs
   - any regulatory changes due to foreign political risk including the collapse of a foreign economy or government,
   - freezing of foreign assets or war

21. **Regulatory Investigation Defense Legal Expense Reimbursement**: Provides regulatory investigation defense legal expense reimbursement to the named individual insured’s company for regulatory investigations by governmental units against the insured’s company.

22. **Tax Audit Defense Legal Expense Reimbursement**: Provides tax audit defense legal expense reimbursement to the named individual insured's company.

23. **Tax Liability**: Provides coverage for any unexpected tax liability equal to and above 115% of filed tax liability due to a final legal decision. Also, coverage is provided for defense expenses to determine tax liability in court.

24. **Tenant Discrimination, Harassment and Wrongful Eviction**: Provides coverage for any claims resulting from actual or alleged discrimination, harassment, or wrongful eviction. Claims must be made by a tenant, legal occupant, or non-employee of the individual insured.
25. **Terrorism**: Provides coverage for lost, destroyed, impaired, or damaged property resulting from a direct or indirect act of terrorism. Also, coverage is provided for loss of income resulting from direct or indirect act of terrorism. An act of terrorism is defined as an act of any person acting on behalf of or in connection with any organization with activities directed towards the overthrowing or influencing of any government by force or violence. This coverage excludes any property in transit, vehicles licensed for road use or watercraft.

26. **Trade Credit**: Provides coverage for corporate receivables in the event that debtors to the named individual insured’s company file bankruptcy or otherwise become insolvent.

27. **Transportation Damages**: Provides coverage for loss of income and additional expenses resulting from damage to packages in the care of the insured. Additional expenses include repair or replacement of the packages. Coverage only applies to those customers who constitute 10% or more of the annual revenue. This policy is designed for distribution/transportation companies.

28. **Warranty**: Provides coverage for all expenses incurred relating to the repair or replacement of products that are manufactured or rebuilt by the Insured. Insurance company is covering risk of dysfunctional products being distributed by insured.

29. **Warranty Shortfall**: Provides reimbursement of expenses related to work on a product sold by the Insured and not reimbursed by the manufacturer of the product as part of the manufacturer's warranty.

30. **Work Stoppage**: Provides coverage for all expenses incurred by insured relating to a work stoppage by any producer of the insured’s inventory. Coverage includes loss of income and additional taxes that might be due as the result of the loss of a tax benefit in the form of tax savings derived from the LIFO method of accounting. This policy is similar to the loss of key supplier policy, except here, the loss of the supplier is not due to a business decision but rather some type of strike.

Below is just some supportive information that you probably already have to be used as you see fit.

**TITLE 26 > Subtitle A > CHAPTER 1 > Subchapter L > PART II > § 831**

§ 831. Tax on insurance companies other than life insurance companies

(a) **General rule**

Taxes computed as provided in section 11 shall be imposed for each taxable year on the taxable income of every insurance company other than a life insurance company.

(b) **Alternative tax for certain small companies**

(1) **In general**

In lieu of the tax otherwise applicable under subsection (a), there is hereby imposed for each taxable year on the income of every insurance company to which this subsection applies a tax computed by multiplying the taxable investment income of such company for such taxable year by the rates provided in section 11 (b).

(2) **Companies to which this subsection applies**

(A) **In general**

This subsection shall apply to every insurance company other than life (including interinsurers and reciprocal underwriters) if—
(i) the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed $1,200,000, and

(ii) such company elects the application of this subsection for such taxable year.

The election under clause (ii) shall apply to the taxable year for which made and for all subsequent taxable years for which the requirements of clause (i) are met. Such an election, once made, may be revoked only with the consent of the Secretary.

(B) Controlled group rules

(i) In general For purposes of subparagraph (A), in determining whether any company is described in clause (i) of subparagraph (A), such company shall be treated as receiving during the taxable year amounts described in such clause (i) which are received during such year by all other companies which are members of the same controlled group as the insurance company for which the determination is being made.

(ii) Controlled group For purposes of clause (i), the term “controlled group” means any controlled group of corporations (as defined in section 1563 (a)); except that—

(I) “more than 50 percent” shall be substituted for “at least 80 percent” each place it appears in section 1563 (a), and

(II) subsections (a)(4) and (b)(2)(D) of section 1563 shall not apply.

(3) Limitation on use of net operating losses

For purposes of this part, except as provided in section 844, a net operating loss (as defined in section 172) shall not be carried—

(A) to or from any taxable year for which the insurance company is not subject to the tax imposed by subsection (a), or

(B) to any taxable year if, between the taxable year from which such loss is being carried and such taxable year, there is an intervening taxable year for which the insurance company was not subject to the tax imposed by subsection (a).

(c) Insurance company defined

IRC Section 953(d) Election by Foreign Insurance Company to be treated as domestic corporation

(d) Election by foreign insurance company to be treated as domestic corporation

(1) In general
If—
(A) a foreign corporation is a controlled foreign corporation (as defined in section 957 (a) by substituting “25 percent or more” for “more than 50 percent” and by using the definition of United States shareholder under 953(c)(1)(A)),
(B) such foreign corporation would qualify under part I or II of subchapter L for the taxable year if it were a domestic corporation,
(C) such foreign corporation meets such requirements as the Secretary shall prescribe to ensure that the taxes imposed by this chapter on such foreign corporation are paid, and
(D) such foreign corporation makes an election to have this paragraph apply and waives all benefits to such corporation granted by the United States under any treaty, for purposes of this title, such corporation shall be treated as a domestic corporation.
(2) **Period during which election is in effect**
(A) **In general**
Except as provided in subparagraph (B), an election under paragraph (1) shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.
(B) **Termination**
If a corporation which made an election under paragraph (1) for any taxable year fails to meet the requirements of subparagraphs (A), (B), and (C), of paragraph (1) for any subsequent taxable year, such election shall not apply to any taxable year beginning after such subsequent taxable year.
(3) **Treatment of losses**
If any corporation treated as a domestic corporation under this subsection is treated as a member of an affiliated group for purposes of chapter 6 (relating to consolidated returns), any loss of such corporation shall be treated as a dual consolidated loss for purposes of section 1503 (d) without regard to paragraph (2)(B) thereof.
(4) **Effect of election**
(A) **In general**
For purposes of section 367, any foreign corporation making an election under paragraph (1) shall be treated as transferring (as of the 1st day of the 1st taxable year to which such election applies) all of its assets to a domestic corporation in connection with an exchange to which section 354 applies.
(B) **Exception for pre-1988 earnings and profit**
(i) **In general**
Earnings and profits of the foreign corporation accumulated in taxable years beginning before January 1, 1988, shall not be included in the gross income of the persons holding stock in such corporation by reason of subparagraph (A).
(ii) **Treatment of distributions**
For purposes of this title, any distribution made by a corporation to which an election under paragraph (1) applies out of earnings and profits accumulated in taxable years beginning before January 1, 1988, shall be treated as a distribution made by a foreign corporation.
(iii) **Certain rules to continue to apply to pre-1988 earnings**
The provisions specified in clause (iv) shall be applied without regard to paragraph (1), except that, in the case of a corporation to which an election under paragraph (1) applies, only earnings and profits accumulated in taxable years beginning before January 1, 1988, shall be taken into account.
(iv) **Specified provisions**
The provisions specified in this clause are:
(I) Section 1248 (relating to gain from certain sales or exchanges of stock in certain foreign corporations).
(II) Subpart F of part III of subchapter N to the extent such subpart relates to earnings invested in United States property or amounts referred to in clause (ii) or (iii) of section 951 (a)(1)(A).
(III) Section 884 to the extent the foreign corporation reinvested 1987 earnings and profits in United States assets.
(5) **Effect of termination**
For purposes of section 367, if—
(A) an election is made by a corporation under paragraph (1) for any taxable year, and
(B) such election ceases to apply for any subsequent taxable year, such corporation shall be treated as a domestic corporation transferring (as of the 1st day of such subsequent taxable year) all of its property to a foreign corporation in connection with an exchange to which section 354 applies.
(6) **Additional tax on corporation making election**
(A) **In general**
If a corporation makes an election under paragraph (1), the amount of tax imposed by this chapter for the 1st taxable year to which such election applies shall be increased by the amount determined under subparagraph (B).
(B) **Amount of tax**
The amount of tax determined under this paragraph shall be equal to the lesser of—
(i) 3/4 of 1 percent of the aggregate amount of capital and accumulated surplus of the corporation as of December 31, 1987, or
(ii) $1,500,000.

e) Exempt insurance income
For purposes of this section—
(1) Exempt insurance income defined
(A) In general
The term “exempt insurance income” means income derived by a qualifying insurance company which—
(i) is attributable to the issuing (or reinsuring) of an exempt contract by such company or a qualifying insurance company branch of such company, and
(ii) is treated as earned by such company or branch in its home country for purposes of such country’s tax laws.
(B) Exception for certain arrangements
Such term shall not include income attributable to the issuing (or reinsuring) of an exempt contract as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect of issuing (or reinsuring) a contract which is not an exempt contract.
(C) Determinations made separately
For purposes of this subsection and section 954 (i), the exempt insurance income and exempt contracts of a qualifying insurance company or any qualifying insurance company branch of such company shall be determined separately for such company and each such branch by taking into account—
(i) in the case of the qualifying insurance company, only items of income, deduction, gain, or loss, and activities of such company not properly allocable or attributable to any qualifying insurance company branch of such company, and
(ii) in the case of a qualifying insurance company branch, only items of income, deduction, gain, or loss and activities properly allocable or attributable to such branch.
(2) Exempt contract
(A) In general
The term “exempt contract” means an insurance or annuity contract issued or reinsured by a qualifying insurance company or qualifying insurance company branch in connection with property in, liability arising out of activity in, or the lives or health of residents of, a country other than the United States.
(B) Minimum home country income required
(i) In general No contract of a qualifying insurance company or of a qualifying insurance company branch shall be treated as an exempt contract unless such company or branch derives more than 30 percent of its net written premiums from exempt contracts (determined without regard to this subparagraph)—
(II) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954 (d)(3)).
(ii) Applicable home country risks The term “applicable home country risks” means risks in connection with property in, liability arising out of activity in, or the lives or health of residents of, the home country of the qualifying insurance company or qualifying insurance company branch, as the case may be, issuing or reinsuring the contract covering the risks.
(C) Substantial activity requirements for cross border risks
A contract issued by a qualifying insurance company or qualifying insurance company branch which covers risks other than applicable home country risks (as defined in subparagraph (B)(ii)) shall not be treated as an exempt contract unless such company or branch, as the case may be—
(i) conducts substantial activity with respect to an insurance business in its home country, and
(ii) performs in its home country substantially all of the activities necessary to give rise to the income generated by such contract.
(3) Qualifying insurance company
The term “qualifying insurance company” means any controlled foreign corporation which—
(A) is subject to regulation as an insurance (or reinsurance) company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954 (d)(3)) in such home country,
(B) derives more than 50 percent of its aggregate net written premiums from the issuance or reinsurance by such controlled foreign corporation and each of its qualifying insurance company
branches of contracts—
(i) covering applicable home country risks (as defined in paragraph (2)) of such corporation or branch, as the case may be, and
(ii) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954 (d)(3)),
except that in the case of a branch, such premiums shall only be taken into account to the extent such premiums are treated as earned by such branch in its home country for purposes of such country’s tax laws, and
(C) is engaged in the insurance business and would be subject to tax under subchapter L if it were a domestic corporation.

(4) Qualifying insurance company branch
The term "qualifying insurance company branch" means a qualified business unit (within the meaning of section 989(a)) of a controlled foreign corporation if—
(A) such unit is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954 (d)(3)) in such home country, and
(B) such controlled foreign corporation is a qualifying insurance company, determined under paragraph (3) as if such unit were a qualifying insurance company branch.

(5) Life insurance or annuity contract
For purposes of this section and section 954, the determination of whether a contract issued by a controlled foreign corporation or a qualified business unit (within the meaning of section 989 (a)) is a life insurance contract or an annuity contract shall be made without regard to sections 72 (s), 101 (f), 817 (h), and 7702 if—
(A) such contract is regulated as a life insurance or annuity contract by the corporation’s or unit’s home country, and
(B) no policyholder, insured, annuitant, or beneficiary with respect to the contract is a United States person.

(6) Home country
For purposes of this subsection, except as provided in regulations—
(A) Controlled foreign corporation
The term “home country” means, with respect to a controlled foreign corporation, the country in which such corporation is created or organized.
(B) Qualified business unit
The term “home country” means, with respect to a qualified business unit (as defined in section 989 (a)), the country in which the principal office of such unit is located and in which such unit is licensed, authorized, or regulated by the applicable insurance regulatory body to sell insurance, reinsurance, or annuity contracts to persons other than related persons (as defined in section 954 (d)(3)) in such country.

(7) Anti-abuse rules
For purposes of applying this subsection and section 954 (i)—
(A) the rules of section 954 (h)(7) (other than subparagraph (B) thereof) shall apply,
(B) there shall be disregarded any item of income, gain, loss, or deduction of, or derived from, an entity which is not engaged in regular and continuous transactions with persons which are not related persons,
(C) there shall be disregarded any change in the method of computing reserves a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of this subsection or section 954 (i),
(D) a contract of insurance or reinsurance shall not be treated as an exempt contract (and premiums from such contract shall not be taken into account for purposes of paragraph (2)(B) or (3)) if—
(i) any policyholder, insured, annuitant, or beneficiary is a resident of the United States and such contract was marketed to such resident and was written to cover a risk outside the United States, or
(ii) the contract covers risks located within and without the United States and the qualifying insurance company or qualifying insurance company branch does not maintain such contemporaneous records, and file such reports, with respect to such contract as the Secretary may require,
(E) the Secretary may prescribe rules for the allocation of contracts (and income from contracts) among 2 or more qualifying insurance company branches of a qualifying insurance company in order to clearly reflect the income of such branches, and
(F) premiums from a contract shall not be taken into account for purposes of paragraph (2)(B) or (3) if such contract reinsures a contract issued or reinsured by a related person (as defined in section 954 (d)(3)).

For purposes of subparagraph (D), the determination of where risks are located shall be made under the principles of section 953.
(8) **Coordination with subsection (c)**
In determining insurance income for purposes of subsection (c), exempt insurance income shall not include income derived from exempt contracts which cover risks other than applicable home country risks.

(9) **Regulations**
The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection and section 954 (i).

(10) **Application**
This subsection and section 954 (i) shall apply only to taxable years of a foreign corporation beginning after December 31, 1998, and before January 1, 2007, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends. If this subsection does not apply to a taxable year of a foreign corporation beginning after December 31, 2006 (and taxable years of United States shareholders ending with or within such taxable year), then, notwithstanding the preceding sentence, subsection (a) shall be applied to such taxable years in the same manner as it would if the taxable year of the foreign corporation began in 1998.

(11) **Cross reference**
For income exempt from foreign personal holding company income, see section 954 (i).

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