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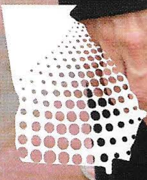

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Georgia: More Captivating Than Ever

J. Scot Kirkpatrick and Christopher A. Steele

Many business owners are utilizing the benefits of captive insurance companies. These benefits include managing the risk of related businesses, including otherwise uninsurable risks, access to reinsurance markets and reducing outside premium costs. Since 1986, Congress has induced businesses to better manage their property and casualty risk through this form of "self-insurance" by creating a small captive insurance company, which elects to be governed by Section 831(b) of the Internal Revenue Code.

With the increased focus on captives for owners of small- to medium-size businesses, many states have been updating and improving their captive insurance statutes. Georgia held off on this for a long while, and that put the state at a competitive disadvantage with virtually all Georgia businesses setting up their captives in other jurisdictions.

This year, however, Georgia became the latest state to make improvements to its captive laws.

Although Georgia has been a captive domicile since 1988, the current number of licensed captives in the Peach State has been negligible. That soon may change. On May 5, Gov. Nathan Deal signed House Bill 552 into law, ushering in a new era in captive insurance companies within the state. House Bill 552 is a significant improvement in the laws that govern captives in Georgia, and will likely be the beginning of a revival of this risk management tool.

Effective July 1, 2015, the new law lessens several substantial burdens to forming and managing captives in Georgia. The changes include:

- Reducing the amount of minimum capital surplus for pure captives to $250,000, from the previous amount of $500,000;
- Reducing the tax rate of Georgia captives to 0.4 percent on the first $20 million of direct premiums collected and 0.3 percent on each dollar of direct premiums collected above $20 million;
- Reducing the tax rate of Georgia captives to 0.225 percent on the first $20 million of assumed reinsurance premium, 0.150 percent on the second $20 million of assumed reinsurance premium, 0.050% on the next $20 million and 0.025% on any dollar above $60 million;
- Reducing the aggregate maximum premium tax to $100,000;
- Clarifying when two or more captives will be considered part of the same controlled group rules; and,
- Requiring that the board of directors (not less than three) of the captive hold at least one meeting per year in Georgia, and contain at least one director that is a resident of Georgia (reducing this from one-third of all directors).

In addition to House Bill 552, the Georgia General Assembly will consider a second bill in the 2016 session, House Bill 703, which allows for the creation of protected cells, segregated cells and special purpose vehicles. This second bill and the regulations currently being drafted to implement House Bill 552 are the next steps in making Georgia a competitive captive insurance state.

Small captive insurance companies are those eligible to elect to be taxed only on investment income and with

net written premiums not exceeding $1.2 million in a tax year, provided that the company also makes an affirmative election under Section 831(b). The Section 831(b) election requires tax to be paid only on investment income at corporate rates. However, net operating losses do not offset investment income, and cannot be carried to or from any tax year for which the company has made an election under Section 831(b).

One of the Congressional inducements to make the election to be a "small" property and casualty captive is that the operating company (i.e., the insured) deducts the premiums, and those premiums (up to $1.2 million) are effectively tax-exempt income to the captive. Specifically, the business would receive a deduction for premiums paid to the captive under Section 162, and up to $1.2 million of those premiums would be exempt from income tax at the captive level under Section 831(b).

Despite the benefits of creating a captive, it is important to recognize the risks and responsibilities that accompany them. There are opportunities for the Internal Revenue Service to challenge captives; therefore, proper formation and ongoing administration is essential. The captive must be a legitimate business entity and be in compliance with the law.

For example, a captive must write "insurance" in the traditional sense including adequate risk shifting and risk distribution, and the captive cannot be the recipient of excessive premiums.

While captives may be popular with the IRS, the Tax Court has defeated several IRS challenges to adequate risk shifting and risk distribution in Rent-A-Center, Inc. v. Commissioner, 142 T.C. 1 (Jan 14, 2014), and Securitas Holdings, Inc. v. Commissioner, T.C. Memo. 2014-225 (October 29, 2014).

Despite these defeats, the IRS is still examining captives on a case-by-case basis, and it is important that a captive be formed properly and for the right reason—to manage risk.

If a business owner is considering a captive insurance company, it is important that they work with an advisor who understands the various risks and responsibilities that accompany these types of structures. A qualified attorney and CPA are essential in guiding a client through the process, including the formation of the captive. It also is critically important that the client be connected with a good captive manager who can evaluate the business' needs and make recommendations related to the proper structure.

With the continued scrutiny by the IRS, there are potential pitfalls to forming a captive into which a business can stumble. However, those who enter the world of captive insurance companies with their eyes wide open and with the right team will discover that a properly structured captive insurance company can be an invaluable business tool.

IN BRIEF

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