**The Essence of the Captive Insurance Strategy**

A captive insurance company is a small property and casualty insurance company that is privately owned. The purpose of the company is to insure risks of an operating company.

The captive insurance company is not created to replace the insurance coverage currently being purchased from a commercial insurance company, but to insure "other risks" that might exist in the operating company. A few examples of such risks might include business litigation, data breach, change in operating environment due to a loss of principal customer, principal vendor or key employee, or regulatory risk. Insured risks could also include current deductibles and exclusions on commercial insurance coverage. These "other risks" are determined by a study conducted by an independent actuarial firm.

The process undertaken and important points to understand are:

- Independent actuarial study of the risks and the pricing of such risks and to determine the business purpose of the coverages.
- Formation and licensing of the insurance company.
- The operating company purchases insurance coverage for the risks determined in the underwriting and feasibility study.
- The operating company takes a tax deduction under IRC 162 (a) for the insurance purchased.
- The captive insurance company makes an election under IRC 831 (b), which allows up to $2.3 million in premium to be exempt from current tax, annually. (The minimum premium that is advisable for the captive program is $400,000 annually.)
- Owners of the insurance company maintain control over the money inside the captive.
- When money is distributed out of the captive insurance company to the shareholders, it is taxed at a preferred tax rate:
  - Qualified dividend rate of 20% plus 3.8%
  - Tax liquidation of the insurance company at long-term capital gain rates.

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