

BUSINESS INSURANCE

WORLD

CAPTIVE FORUM

P/C Track:
Small Captives:
What You Need to
Know NOW



Charles "Chaz" Lavelle
Bingham Greenebaum Doll
LLP

MODERATOR



Robert Kornahrens
Advanced Roofing



Renea Louie
Pro Group Captive
Management Services

Today's Presenters



**Robert Kornahrens, CEO
President
Advanced Roofing, Inc.**

35+ years in commercial roofing contractor business specializing in roof replacements, repairs, and maintenance services in Florida and the Caribbean
Captive owner 13 years



**Renea Louie, ARM, ACI, Fellow
Vice President
Pro Group Captive Management Services**

29 years experience in Executive Level and Senior Management. Extensive experience in captives and alternative risk transfer. Captive Management 15 years



**Charles "Chaz" Lavelle
Senior Partner
Bingham Greenebaum Doll**

40+ years experience in tax controversy work with an emphasis on taxation of captive insurance companies

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Established in 1983, Advanced Roofing Inc. is a full-service commercial roofing contractor specializing in roof replacements, repairs, and maintenance services for occupied buildings in Florida and the Caribbean with 50+ service trucks and state of the art technology.

Advanced Roofing is Florida's top-ranked commercial re-roofing contractor by [Roofing Contractor Magazine](#) and the [South Florida Business Journal](#).

Today, ARI has 7 branches and employs approximately 500 people.

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Advanced Roofing formed their first captive with Pro Group in 2006.
Their business services include:



Re-Roofing	Waterproofing
Repairs	Solar Energy
Emergency Repair	Skylights
Roof Maintenance	Air Conditioning
Roof Management	Crane Division
New Construction	Lightning protection
Roof Coatings	Sheet Metal

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Operation of Small Captive Topics

- Risks insured
- Operational things to consider
- Domicile choice
- Growing over the years

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Business Purpose

Advanced Roofing (ARI) is a customer driven Company and has a competitive advantage over its competitors through its captive, ARI Insurance.

South Florida has challenges

Weather
Heat
Labor
Competition

ARI allows Advanced Roofing to differentiate itself in a very competitive market. By offering an extended warranty product to customers, they put their money where their mouth is when it comes to quality workmanship.

The captive has allowed us to create a new profit center and we have been pleased with the number of customers who have selected AR because we offer this this product.

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Business Purpose

Customer Satisfaction

When a customer has an issue, we want to resolve it as soon as possible without involving the commercial insurance company.

In the roofing business, competitive commercial insurance is hard to come by.

The captive allows us to take a reasonable deductible – the discount in the commercial premium makes the retention worthwhile, but more importantly, it gives AR control.

The claim can literally be handled “on site” up to \$20,000 which is AR’s retention amount. Involving commercial insurance generally takes more time, involves more of AR’s administration, and generally creates more expense.

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Enterprise Risk Management

Business Purpose

We buy insurance to protect our Assets. Inherent with our operations are areas of risk that we choose to insure in ARI.

The key to being competitive in the roofing business is controlling cost. Part of the process of creating our captive was a comprehensive exploration of our risk—supply chain, labor and economic

ARI helped the company survive the downturn in 2008-10 the coverage AR was buying commercially and the coverage most beneficial to be provided by ARI

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Risks Insured

- Solar Panels
- General Liability Deductible Reimbursement
- Umbrella Liability
 - Errors and omissions
 - Design professional liability
 - Construction defect
 - Cyber Liability and Breach protection
- Assignment and Assumption of Warranty Liabilities



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ARI




ARI II

The Next Generation

Advanced Roofing is a family business. The business purpose for creating the captive is the same purpose that will see the company transition to the next generation. And the expansion of the captive.

The success of ARI will depend upon the volume of unrelated risk premium.

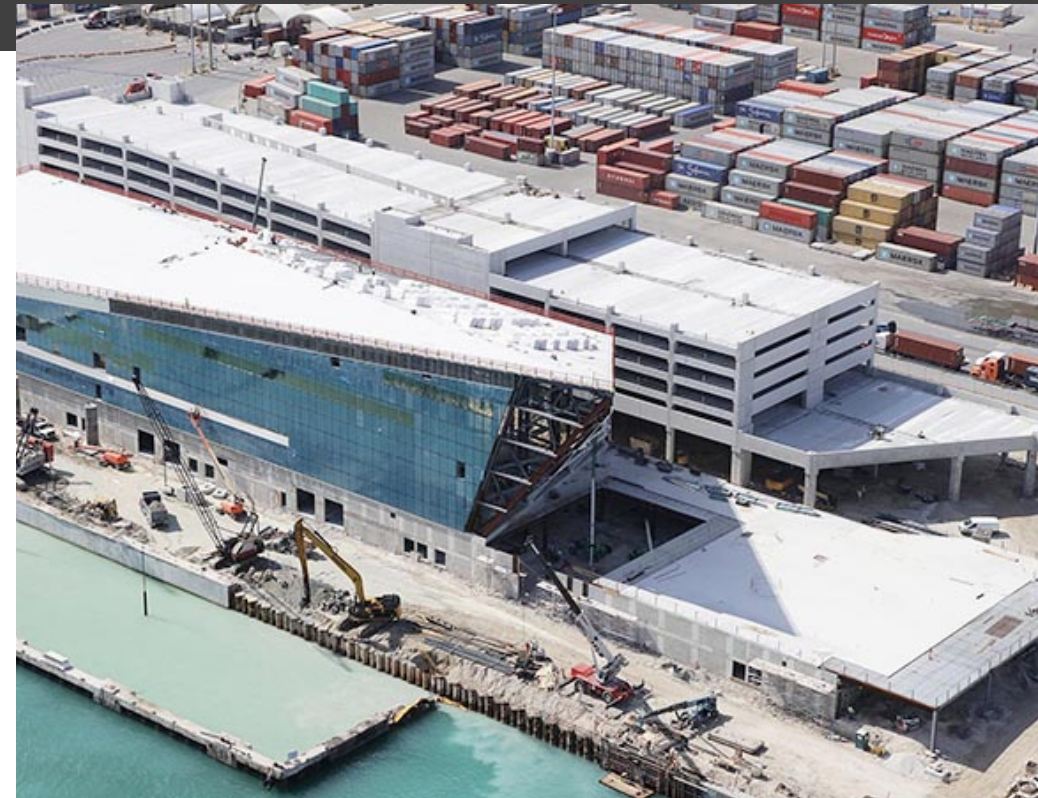


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Insurance Company Operations

- Roofers—not insurance folks (they probably don't like insurance)
- Great Advanced Roofing Staff
- Trusted Advisors who know Advanced Roofing's business
 - Captive Manager
 - Risk Management Advisor
 - Actuary
 - CPA
 - Frequent Interaction is key as well as underwriting the captive every year



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Insurance Company Operations



- Annual Board Meeting
- Quarterly Financial Statements
- Quarterly discussions, investments, claims, sales
- Annual underwriting – renewal of program
- Claims reporting quarterly
- Annual Financials, Independent Audit
- Independent Actuarial report
- Safety
- ARI dormant, ARI II in full swing

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Onshore Domiciles 2006

- Alabama
- Colorado
- Delaware
- District of Columbia
- Florida
- Georgia
- Hawaii
- Kansas
- Kentucky
- Maine
- Montana
- Nevada
- New York
- South Carolina
- Tennessee
- Texas
- Utah
- Vermont
- Virginia
- West Virginia



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Onshore Domiciles 2020

- Alabama
- Arizona
- Arkansas
- Colorado
- Connecticut
- Delaware
- Delaware Tribe of Indians
- District of Columbia
- Florida
- Georgia
- Guam
- Hawaii
- Illinois
- Kansas
- Kentucky
- Louisiana
- Maine
- Michigan
- Missouri
- Montana
- Nebraska
- Nevada
- New Jersey
- New York
- North Carolina
- Ohio
- Oklahoma
- Oregon
- Puerto Rico
- Rhode Island
- South Carolina
- South Dakota
- Tennessee
- Texas
- US Virgin Islands
- Utah
- Vermont
- Virginia
- West Virginia

39 Offshore Domiciles today

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State of Nevada



Department of Business and Industry

DIVISION OF INSURANCE

Nevada Captive Filing Requirements

Required Filings for Nevada

I. Financial Statements

Annual Report of Financial Conditions

3/1

RRG Quarterly Financial Statement

5/15, 8/15, 11/15

II. Audited Financial Statements

Audited Financial Statement

6/30

Letter of Qualification

6/30

Statement of Actuarial Opinion

6/30

Statement of Actuarial Summary

6/30

III. Additional Required Annual Filings

Premium Tax

3/1

License Renewal Fees

3/1

Business Plan

3/1

Annual Report

3/1

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State of Nevada



Department of Business and Industry

DIVISION OF INSURANCE

Nevada Premium Tax Form

NEVADA ANNUAL CAPTIVE INSURANCE PREMIUM TAX RETURN			
2019		Due on or before March 1, 2020	
Remit filing and payment to: State of Nevada Attn: Division of Insurance, Captive Premium Tax 1818 E. College Parkway, Suite 103, Carson City, NV 89706 TAX OVER \$10,000 MUST BE PAID BY ACH OR EFT		For Assistance or Questions: rgallegos@doj.nv.gov Captive Section Phone: (775) 687-0748 Captive Section Fax: (775) 687-0787	
Captive Company Name		Company Captive ID:	Federal ID:
Captive Legal Address		Person to contact regarding this return:	
		Phone Number:	
		Email Address:	
Mark			
<input checked="" type="checkbox"/> X		Mark if original return	
<input type="checkbox"/>		Mark if amended return filing and include a copy of the original return	
All Captives: \$5000 Minimum and \$175,000 Maximum Aggregate Annual Tax pursuant to NRS 694C.450.3			
Net Direct Premiums	Premium	Tax Rate	Premium Tax
1 \$0 to \$20,000,000		x 0.400%	\$0
2 \$20,000,001 to \$40,000,000	\$0	x 0.200%	\$0
3 Over \$40,000,000	\$0	x 0.075%	\$0
4 Total Net Direct Premiums (Taxes)	\$0		\$0
Assumed Reinsurance			
5 \$0 to \$20,000,000	\$0	x 0.225%	\$0
6 \$20,000,001 to \$40,000,000	\$0	x 0.150%	\$0
7 Over \$40,000,000	\$0	x 0.025%	\$0
8 Total Assumed Premium (Taxes)	\$0	x	\$0
9 Total Premiums (add lines 4 + 8)	\$0	Total Tax Due (add lines 4 + 8)	\$0
10 <input type="checkbox"/>	Place X in the box if electing one-time non-refundable credit of \$5,000 per 694C.450.7		
11 Net Premium Tax due (Line 9 if greater than minimum less line 10 or minimum tax \$5,000)			\$5,000
12 Enter total previous payments applied to this return or credit balance to date			\$0
13 Total Net Amount Due or Credit balance (line 11-12)			\$5,000
14 Amount Enclosed (If a Credit Balance, it will carry forward to next year)			
Please make Checks Payable to: State of Nevada Division of Insurance			
THE CAPTIVE "ANNUAL REPORT OF FINANCIAL CONDITION" CAN BE REMITTED WITH THIS RETURN OR INDEPENDENTLY ON OR BEFORE MARCH 1st PER NRS 694C.400			
I hereby certify this return is true, correct and complete to the best of my knowledge (at least one signature required)			
15	Signature of taxpayer or authorized agent	Name and Title of taxpayer or authorized agent	Date Telephone #
16	Signature - Pure Captives required second signature	Name and Title of Authorized Officer	Date Telephone #
STATE DEPARTMENT USE ONLY			
Fund	Dept/Agency	Bgt/Appr Unit	GL/Object
101	7413100	974100	3067 (75%)
101	7413100	381800	4325 (25%)
Amount	Amount Rvd	Date Received	Payment No.
		/ /	Verified
	Recorded		Invoiced

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CAPTIVE MANAGER KEY TO YOUR SUCCESS

ARI relies on Pro Group to keep them abreast of

- Domicile changes
- Regulator changes
- Rule and filing updates
- Statutory changes
- Legislative changes being floated and their possible affects
- National discussions occurring on key topics that can affect captives onshore



PRO GROUP
CAPTIVE MANAGEMENT SERVICES

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Notice 2016-66 Abusive Indicators

IRS is concerned with Abuse and Small Captives

- “Dirty Dozen” IRs 2015-19, 2016-25, 2017-31, 2018-62, 2019-47
- Notice 2016-66 abusive indicators:

Contracts:

- covers implausible risks, no business need, vague or illusory coverage, duplicates commercial coverage

Premiums:

- wants deduction, no industry standard underwriting or actuarial analysis, not paid per payment schedule, no competitive premiums sought, significantly excessive premiums, improper intercompany allocation

Claims and management:

- Captive does not follow statutory and regulatory requirements, not timely issue policies and binders, claims procedures not consistent with industry standards, insured does not file claims for each loss

Capital

- Inadequate capital, invest in illiquid or speculative assets, loans to affiliates

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IRS Audits/Appeals

- Exhaustive IDRs (Information Document Requests)
 - All emails, brochures, marketing material, conversations, tax advice received
 - How did you learn about the captive, next actions, persons consulted
 - Commercial policies, risk management, pricing, prior losses, investments
- Exam Insurance Specialists
- Number of audits, etc.
 - IR-2019-47: more than 500 docketed cases in Tax Court, numerous income tax examinations and promoter investigations
 - IR-2019-47: up to 200 taxpayers offered a settlement by Exam (no years in court)
- LB&I “campaigns”, one of first 13; campaign materials to be released
- Tax Shelter Promotion Investigations
- Appeals, Insurance Specialists
- IRS Exam Settlement program IR-2019-157; will settlement initiative be expanded to more taxpayers?



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Court Concerns in Small Captive Cases

- The IRS has won against Avrahami, Reserve Mechanical and Syzygy
- The Courts have found the pooling entity is not an insurance company for tax purposes, and that risks assumed from the pool are not taken into account in computing risk distribution
 - Why is the ceding entity's status relevant? Compare this with Rev. Rul. 2009-26
- The Courts have been skeptical of a pool whereby the premiums for the risks assumed by the pool are comparable (net of ceding commission) to the premiums assumed from the pool
 - Compare to the Private Rulings approving pools
- Circular Flow of Funds
- Common Notions of Insurance
 - Captive organized, operated and regulated as an insurance company
 - Capitalization
 - Valid and Binding Policies
 - Claims
 - Pricing

Court Concerns in Small Captive Cases

- Claims
 - \$100,000 of claims were not filed because the principal was too busy
 - Claims not filed until after the tax audit started
- Investments
 - 2/3 of the assets were loaned to kids' entity with no principal or interest due for 10 years
 - 1/2 of the assets purchased split dollar life insurance that the captive did not own, and the captive could not obtain the cash surrender value (or take other actions) without approval that the Court did not believe would be obtained
- Premiums
 - Taxpayer could not prove why captive coverage was more expensive than commercial coverage
 - No one proved why the premiums allocated to the pool were proper
 - Expensive captive coverage added to (did not replace) inexpensive commercial coverage
- Cookie Cutter policies

Court Concerns in Small Captive Cases

- The principal did not understand the insurance program
- The principal changed captive managers when the premiums went down
- The principal would freak if he lost money on the pool
- The policy language was a mixture of occurrence and claims made
- The policy terms were confusing; policies provided for a 7-day claim-filing period at policy year end; and the premium was earned at inception
- In Syzygy the Court disallowed the premium deduction, and then taxed the captive on the premium for lack of proof of non-taxability
- Syzygy also said that there was nothing in the statute that precluded a deduction for premiums paid to a “micro-captive”
- Even if not technically insurance, the premiums may still be deductible indemnity payments

Industry Activities

- CICA Paper – January 2019
 - Pools
 - Equal amount of premiums in and out
 - Commercial policies for multiple entities
 - Commercial coverage and captive coverage
 - Outside service providers
 - No requirement of prior loss
 - Vehicle service contracts
 - Standard policy language
 - Setting premiums
- SIIA – very extensive legislative and administrative activity; amicus briefs
- Litigation – amicus briefs, including state associations
- American Bar Association comments
- CIC vs US – challenging issuance of Notice 2016-66; cert to U.S. Supreme Court requested

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Final Thoughts

Do the below make an arrangement good?

- Non-Tax Business Purpose
- Risks Insured
- Pricing
- Claims
- Investments
- Capital
- Regulation
- Ownership
- One Captive
- Documentation



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Concluding Thoughts



A tenet of determining if a business decision is a good decision is whether you'd make the same decision again

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Questions



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Thank You



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