# A Tax Paradise Right Here at Home

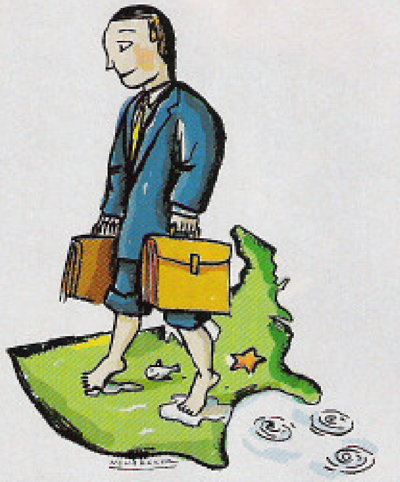
## Hundreds of companies are setting up captive insurance units in receptive states

THINK ALL U.S. COMPANIES looking for tax havens are sending skilled jobs offshore as fast as they can? Try again. More and more are skipping the Bermudas and Cayman Islands of the world. Instead, they're finding a tax paradise onshore when they set up in-house units to self-insure their risks. For years, Vermont was virtually the only U.S. destination for such captive insurers, but now South Carolina, Hawaii, and even the District of Columbia are entering the domestic sweepstakes.

Traditional insurance havens are rapidly losing ground. Last year, Vermont added 64 captives—20 more than longtime leader Bermuda, according to London-based Risk & Insurance Research Group. The Green Mountain State had 507 at the end of 2003, including units set up by Boston Scientific Corp. and Continental Airlines. D.C. had just five captives two years ago but added 14 last year, the same as the British Virgin Islands. Overall, seven U.S. states added a total of 175 captives last year, while the top offshore locales snagged just 109.

South Carolina is typical of the trend. After its lawmakers capped taxes on premiums paid to insurance companies, the state began aggressively marketing Charleston as a cheaper alternative to offshore havens. In Bermuda, for instance, a housing allowance for an executive can cost up to $20,000 a month. After less than four years, the picturesque port city now has roughly 85 insurers and has applications from 25 more—turning it into the 12th-largest captive insurance domicile in the world almost overnight.

Other forces are also erasing the benefits of going offshore. Consultants and tax attorneys say the cut in federal taxes on capital gains, coupled with U.S. demands that offshore havens share the tax records of U.S. companies domiciled there, has leveled the playing field. "Up until the '90s you could do things offshore and no one would ever know about it," says Michael Mead, president of the Chicago insurance consultancy M.R. Mead & Co. "Now, the [Internal Revenue Service] knows where every penny you have is."



### Keeping Captive Insurers in America

Several states are making it attractive for insurers owned by companies to set up in the U.S. instead of in exotic tax havens

| LOCATION | NUMBER OF CAPTIVES 2003 | PERCENT CHANGE FROM 2002 |
|---|---|---|
| Vermont | 507 | 14% |
| Hawaii | 122 | 21 |
| South Carolina | 67 | 123 |
| District of Columbia | 19 | 280 |
| Bermuda | 907 | 5 |
| Cayman Islands | 644 | 7 |
| British Virgin Islands | 296 | 5 |

Data: Risk & Insurance Research Group

### INTO THE POOL

COSTS WERE A BIG ISSUE for the Washington Contract Loggers Assn. last year after it decided to offer group liability coverage to its 1,000 member companies. It found they could save 10% to 40% if they pooled their risks and self-insured. The Olympia (Wash.) group also decided that setting up a captive in Washington, D.C., was cheaper than doing so in Bermuda. "And since you hear about everybody flying the coop to go offshore, we thought it was important to stay here," says Jerry Chertude, who manages the group's insurance program.

The eventual payoff for a state can be big. Vermont began recruiting captives in the 1980s and they now generate $1 billion in annual economic activity. "We're equal to the lottery now" in terms of economic impact, declares Leonard D. Crouse, director of Vermont's captive-insurance division.

Some states insist—shades of the age-old complaints about Bermuda and the Caymans—that companies are unfairly sheltering profits onshore by placing far more reserves with their insurance units than necessary. In the Democratic primaries, Senator John F. Kerry charged that former Vermont Governor Howard Dean had created "a snowy Bermuda in the fields of Vermont."

Some states are taking their grudges to court. Since 2000, Illinois has sued Waste Management Inc. and Exxon Mobil Corp., saying they used Vermont captives to underpay Illinois state taxes. Waste Management and Exxon deny the charges, and the suits are pending. The criticisms are "sour grapes," says Ernst N. Csiszar, South Carolina insurance director until last month, adding that companies "are not allowed to reserve for more than the risk warrants."

For its part, Bermuda questions whether states rushing to become insurance havens have the knowhow to avoid defaults or other blowups that could leave the insured holding the bag. Susan V. Attride-Stirling, assistant marketing director for the Bermuda Monetary Authority, posits that "some of the states are setting up regulations that are more accepting than perhaps we would be." Vermont and South Carolina say that's not the case. For now, the insurance business is no longer a captive of the Caribbean. ■

*–By Dean Foust in Atlanta*