ART GALLERY FOR SEPTEMBER

Captive news leading up to SIIA in Orlando

By Allen Taft

My circuitous route to Orlando has included stops for captive industry conferences in Bermuda and Vermont – two salubrious climes to escape an East Coast heat wave. In Vermont, there were signs that the venerable captive domicile intends to maintain its grip on captive industry numerical leadership, even if it has to overcome a national recession to do so.

Our assumption that a slumping economy could actually stimulate greater interest in captives was borne out in Vermont where deputy insurance commissioner David Provost said ART launches are "getting back to normal." He noted that 14 have been established this year and that there were "four or five applications on our desk, plus a dozen or more companies that have talked to us or visited." All last year there were 16 captives established in the state.

Provost indicated that this year's increased activity "could mean that the market is firming up. It's gone past the bottom, and if the prices aren't going up, then maybe terms and conditions are getting tougher.

National Underwriter reported that captive activity is also picking up in the nation's capital where Dana Sheppard, associate commissioner of the Risk Finance Bureau for the Department of Insurance, Securities and Banking, said, "We're getting more calls, applications and proposals." With some volatility among captive domiciles, Sheppard said that Vermont and the District of Columbia represent stability. "It's like running a marathon," he said. "You have to hang in there and it's starting to pay off."

Sheppard said 19 companies were licensed in DC last year and he expects to see as many as 25 this year. He noted that the domicile is seeing more interest in cell captives. The domicile welcomed a new cell facility set up by Marsh which he said is similar to a rent-a-captive. "They decided to put it here because we have the best cell law."

Cell Taxation Coming?

Speaking of cell captives, the Bermuda conference heard Tom Jones, attorney with McDermott Will & Emery LLP, predict that the IRS will issue by year's end guidance that will treat every cell in a segregated cell company as a separate taxpayer, capable of making its own tax elections and filing its own tax returns under a unique identification number.

I have a habitual knee-jerk reaction to any news from the taxmen, so I sought guidance from Arthur Perschetz, attorney with KilpatrickStockton LLC, who participated in structuring the District of Columbia laws enabling segregated cell captives and, more recently, incorporated cell captives.

"This action by the IRS would provide greater clarity to the cell captive industry," Perschetz said, which I took to be a good thing.

"For contractual cell captives (not individually incorporated), this would eliminate the need for a federal tax sharing agreement within the captive along with any tax issues that could theoretically be created for the rest of the captive," he said.

That was Arthur's polite way of saying that a lagging cell couldn't expect help from other cells if it fell behind in its tax payments.

More important to Arthur would be the additional credibility separate tax treatment would bring to captive cells. "This would put more elements in the equation to support integrity of contractual cells as separate business entities," he said.

The background issue is whether separate captive cells could be found to be inviolate by a court in some future case. To date, there has been no court challenge of the cell system that protects risks and losses in one cell from spreading to others. "With taxation of cells, their protective walls would seem to grow higher and thicker," Perschetz said.

But surprise! There's an "other hand" in Perschetz' analysis. (Aren't all lawyers equipped in law school with that "other hand"? I'm sure most have several spares.) Those domiciles that allow incorporated cells typically would then be able to charge the minimum premium tax for each cell, rather than the minimum and maximum applying to the captive as a whole.

For example, in DC premium tax at a minimum $7,500 and maximum of $100,000 would apply to all the incorporated cells of a captive but only to the parent of a contractual cell captive. "A captive willing to pay the minimum premium tax for each cell would probably be better off as an incorporated cell captive in those domiciles that allow that form," Perschetz said.

Next time we'll report on exciting ART events at the SIIA conference.

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