

ART GALLERY FOR JUNE

There are not just pirates in the Caribbean

By Allen Taft

For Gallery devotees, headlines like “offshore tax havens targeted by U.S.” produce the kind of knee-jerk reaction to mimic the Rockettes. All of us in the captive insurance industry live in a world where the concept of “offshore” is just another selection on the menu but sometimes in a different language.

When the O’s (members of the Obama administration, not the hapless Baltimore Orioles) announced a crackdown on offshore operations of U.S. corporations operating in so-called tax havens, tremors were felt from Wall Street to Front Street. None of us want to be considered as less than model citizens. We who ply our trade in the ART Gallery even in offshore tropics have nothing in common with pirates of the Caribbean.

Captives have provided a marvelous risk management technique for a variety of companies all over the world. Many U.S. corporations operate them offshore as well as in U.S. domestic domiciles. Our immediate fear was that some kind of Orwellian crackdown could put offshore-sited captives at a financial disadvantage.

Turns out that isn’t as big a fear as, say, catching swine flu from tossing your kid’s pigskin. *Business Insurance* writer Rodd Zolkos quoted a highly-placed legal source to say, “There’s nothing specific in the (O’s) concepts that would seem to impact offshore captives in any particular manner.”

It’s like this: most offshore captives of U.S. parents already pay U.S. taxes through the election of IRS Section 953(d) which sets up the foreign corporation to be taxed as though it operates in the U.S. Another industry observer said, “The opportunity for deferral (one of the O’s targets of opportunity) actually doesn’t exist. Based on what I’ve seen, I’d think there will be very little effect on captives.”

Deferral in this sense refers to the federal law that supposedly compensates for U.S. companies’ competitive disadvantage because of higher corporate income tax here than in most other countries (up to 35% compared to 12.5% in Ireland, for example). Under deferral a company doesn’t have to pay the U.S. corporate rate until it repatriates

its earnings. Meanwhile, it can retain earnings overseas or reinvest them abroad with no penalty. But if it brings them home or pays them as dividends the tax bill comes due.

In the case of captives the IRS previously eliminated opportunities for tax deferrals sought by some captive parents.

Another part of the captive taxation equation is comprised of the large number of health care captives that are subsidiaries of parent organizations with nonprofit or charitable status, such as hospitals insuring their malpractice risk. That's a large part of the U.S. captive industry, not even including the number of health care-sponsored risk retention groups that are required to be regulated in a U.S. domicile.

Captive creation strategy is usually less a matter of taxation than of regulation. U.S. companies locate offshore more often for the regulatory environment than for tax purposes.

One possible effect of tax haven legislation could be increased cost and decreased available capacity. Foreign companies who provide a large percentage of the insurance and reinsurance capacity to the U.S. will have higher costs and will charge higher premiums. The U.S. companies argue that the offshore guys are keeping prices down because they operate cheaper. The offshore guys say that's great for the market.

When power to administer the federal government is transferred to the ART Gallery I will immediately eliminate the 35% corporate income tax because that single stroke would bring an unprecedented flow of capital and talent to our shores. Or, if I'm in a collegial mood regarding competing nations I will just lower the rate to the average of 24% and we'll all play nice.

A final point: just the thought of being tarred with the "tax haven" brush could pull some captives back from offshore sites to domestic U.S. domiciles which wouldn't be a bad deal for the captive management and professional services community.

Now, is that a glass half full or what?

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