# BB&T Assurance Company, LTD

## 831 (b) – Micro-Captives

Just as with the mass of an iceberg, many of the inherent risks of operating a business are not readily apparent. These risks are below the surface or hidden in the depths of the balance sheet. A micro captive brings these risks to the surface by establishing a bonafide insurance company. Enacted as part of the Tax Reform Act of 1986 and amended by the Protecting America from Tax Hikes of 2015, Section 831(b) of the Internal Revenue Code allows insurance companies to elect to be taxed only on their investment income, if the company receives less than $2.2 million* in annual premium. The operating company receives a current expense deduction for insurance premiums paid, while the insurance company, choosing the 831(b) election, pays no taxes on its underwriting profit.

To be considered an insurance company, a micro captive must be established with economic substance, the policies must cover insurable risks not business risks, it must be managed to ensure sufficient risk transfer and risk distribution, and operated in accordance with commonly accepted standards of insurance.

**The target profile of a micro captive candidate generally meets most of the following criteria:**

1. *Privately held*
2. *Gross revenue of at least $20 million*
3. *Stable cash flow*
4. *Substantial self-insured/uninsured balance sheet risk*
5. *Consistent pretax profit of at least $1 million*

While ownership of a micro-captive may be flexible, the legislation taking effect on Dec. 31, 2016 encourages that the ownership of the captive virtually mirrors the ownership of the operating company.

A micro-captive acts as an overlay to a traditional risk management program, such as, Workers' Compensation, General Liability, Property and Auto. Most middle-market business owners, by choice or unknowingly, self-insure a significant amount of risk. Previously self-insured enterprise risks are identified, actuarially priced and transferred to the micro captive insurance company. When appropriately structured, the premiums are tax deductible to the operating company, yet not subject to current taxation on underwriting profit within the captive. The potential underwriting profit in the captive, upon distribution, will be taxed at the then current dividend or capital gain rates.

**Risks that could be transferred to a micro-captive include:**

| | | |
|---|---|---|
| Administrative Actions | Pollution | Litigation Defense |
| Directors & Officers | Coastal Wind & Flood | Cyber Liability |
| Supply Chain Interruption | Difference in Conditions | Loss of Key Contract |
| Product Recall | Product/Service Rework | Reputational Risk |
| Loss of Key Employee | Regulatory Changes | Loss of Key Supplier |
| Deductible Reimbursement | Subcontractor Default | Imbedded Warranty |

Lea Riddle MBA, CIC: LRiddle@BBandT.com • 540-525-3703

* Currently $1.2M. $2.2M maximum is effective Dec. 31, 2016.