Captive Strategy

Situation

The client owns 100% of a Sub Chapter S corporation that has annual net income in excess of $2,500,000. The company employs 35 people and is involved in manufacturing, warehousing, and distribution. The client has four life insurance policies on his own life which are all owned by an Irrevocable Trust, and he is looking for the most efficient way to pay the premiums on these policies.

Client Snap Shot

Male, Age 62
Married, no Children
Charitably Inclined
Net Worth $45,000,000 ($40,000,000 of net worth is his business value)

Strategy/Concept/Recommendation

A preliminary analysis of insurable risk for the company was performed by an independent consulting firm. The amount of risk not currently insured through standard commercial insurance was determined to be $1,000,000. A Captive Insurance Company was created and the independent consultants were retained to develop the actuarially determined risk for the company. Then, insurance policies were issued. The Captive Insurance Company is owned by the client, but managed and operated by the independent consulting firm.

Results

- $1,000,000 premium paid to the Captive Insurance Company is fully deductible resulting in current income tax savings to the client of $350,000 per year.
- $1,000,000 premium received by the Captive Insurance Company is fully excludable from income tax under Sec 831(b) and no income tax is owed by the Captive.
- The Captive Insurance Company entered into a private loan arrangement with the Irrevocable Trust to pay the life insurance premiums. Since this is a private loan, current, and extremely low, AFR rates were used, thus making the interest payments on the loan very manageable. The cash value in the insurance policy is used to pay interest on the loan back to the Captive, and the loan is fully backed by the assets of the trust. The Trust will repay the loan balance due to the Captive from the death proceeds of the insurance policy.
- The client has utilized the Captive Insurance Company to obtain $350,000 of current income tax savings, as well as create a source of tax excluded and creditor protected assets to provide for his life insurance costs.