as is found with doctors and medical malpractice or a building contractor with liability concerns, there's a good chance you'll be asked, "Is the creation of a ...

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As an accountant, some individuals or businesses may choose to access just your expertise in accounting and taxes while others will look to take advantage of the other tools in your toolbox. For the latter, who may be interested in growing their money, "What do you think I should do" is a question that may hold the fate of their financial future. Guessing isn't an option.

If your client is in a business that requires them to carry a large insurance policy,

captive insurance company that are not used to pay out claims or premiums to other reinsurers or expenses, are invested and eventually returned upon dissolution of the captive insurance company.

The risk side of the equation here is that the IRS looks at Captive Insurance Companies with a jaundiced eye, very skeptical of the abuses that can exist in this area. Captives have made the IRS "Dirty Dozen" three years in a row as a possible "abusive tax shelter" there's no doubt the risk is real for both you and your client.

Let's assume your client is a doctor who pays $30,000 a year in medical malpractice insurance. While the premiums are fully deductible under IRC Section162 the payments are never seen again and if claims are not made, is simply the profit made by the insurance company.

With a captive your doctor client is, in essence, creating their own insurance company. They own all the shares and are paying that $30,000 a year to a company they own They're still allowed the IRC Section162 deduction but have the added bonus of having those premiums invested and pooled with other captive owners in case of a claim. When the doctor decides to retire or dissolve the captive the premiums he or she paid, along with investment earnings accrued, are paid out as a long-term capital gain. Not only a return of capital, but growth as well!

Your doctor client would no doubt love hearing that second scenario. What could possibly go wrong?

According to the IRS, quite a few things can go wrong. In November, 2016 they released a tax notice (Notice 2016-66) that lays out a series of what they deem to be tax avoidance strategies. It could also be described as a "What not to do" list for anyone setting up a captive. The upside is if you set up a captive correctly, and your client upholds their end of the bargain, you'll survive the inevitable audit.

While you may have a grasp on how captives generally work, and may be able to

clear message regarding the importance of setting up a captive insurance company correctly and avoiding a host of landmines.

Captive Insurance is used by most every Fortune 1000 company in the nation and is becoming more viable to the "Mom and Pop" individual professionals as well. Whereas most captive insurance pools were previously established offshore in places such as Bermuda, Belize and Luxembourg, the majority of states today allow captives which are overseen by local insurance authority agencies and touted as a "business friendly" option. More than 1,000 captive domiciles are found in Vermont and Utah alone.

The IRS has continually challenged the captive insurance model, and will probably continue to do so, as they recognize the very real potential for taxpayer abuse. So when your client asks if a captive is a viable option a few questions you might want to ask yourself are: Will every "i" be dotted and "t" crossed when the captive is created? Will the client pay their premiums on time? Where will the captive domicile be located and, perhaps most importantly, do you and your client have the stomach for a potential audit?

When properly executed for the right reasons, captive insurance can effectively meet both insurance needs and estate planning desires. If done correctly, the "reward" outweighs the "risk" of audit.

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