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and its insureds benefit from the captive insurer's underwriting profits.

**Craig Smalley** • Mar. 06, 2018



I was introduced to captives, the more that I got into representing cannabis businesses. It is very hard for cannabis companies to get insurance, and if they do, it's a fortune, and covers nothing. A captive insurer is generally defined as an insurance company that is wholly owned and controlled by its insureds; its primary purpose is to insure the risks of its owners, and its insureds benefit from the captive insurer's underwriting profits.

These points do not clearly distinguish the captive insurer from a mutual insurance

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running it.

Captive insurance is utilized by insureds that choose to

- put their own capital at risk by creating their own insurance company,
- working outside of the commercial insurance marketplace,
- to achieve their risk financing objectives.

You basically form these captives in states like Delaware, and you fund them with your own money. For example, let's say you have a company that forms a captive, and puts \$1 million in it. The captive can only cover losses in the amount of \$1 million. If the damage is more, the owner needs to come out of pocket.

That isn't to say that owners can't band together and place more money in a captive, because they can. The benefits are pooling funds to have more money accessible if there is a disaster, however the money can all be used up on one disaster leaving nothing for the other people that pooled their money.

However, it is NEVER a good thing when captives end up on the IRS's Dirty Dozen List. Notice 2016-66, speaks about "micro-captives." IRC §831(b) states

*(1) In general*

*In lieu of the **tax** otherwise applicable under subsection (a), there is hereby imposed for each **taxable year** on the income of every **insurance company** to which this subsection applies a tax computed by multiplying the taxable investment income of such company for such taxable year by the rates provided in section 11(b).*

*(2) Companies to which this subsection applies*

(A) *In general* This subsection shall apply to every *insurance company* other than life if—

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(iii)

*such company elects the application of this subsection for such *taxable year*.*

*The *election* under clause (iii) shall apply to the *taxable year* for which made and for all subsequent *taxable years* for which the requirements of clauses (i) and (ii) are met. Such an election, once made, may be revoked only with the consent of the Secretary.*

Basically, the problem occurs when you pool monies, the captive is owned by a collection of people or entities, and while the money in a captive can be invested, it can't be distributed to the owners of the captive.

With something like cannabis, you want the captive to be set up by a reputable company. I like the domicile of Delaware, but I'm open to anything. I want the money invested in something safe, and I want to fund it each year. However, I keep getting these emails from these cons that want to set these up for my clients. The last thing I want is to be on the Dirty Dozen List.

Small Business

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