

Captive insurance update



Rent-A-Center, Inc. v. Commissioner: A divided Tax Court allows a deduction for premiums paid to a captive insurance company

January 29, 2014

In brief

On January 14, 2014, the U.S. Tax Court released its opinion in *Rent-A-Center v. Commissioner*, 142 T.C. 1. In that case, a parent corporation established a captive insurance subsidiary in Bermuda to insure a substantial volume of workers' compensation, automobile and general risks of its other subsidiaries. Although the parent was a named insured, the risks insured were risks of the subsidiaries. The reason for forming the insurance subsidiary was to manage risks of the group at more reasonable rates than were available from unrelated insurance companies. A number of "adverse" facts existed in the case including that the insurance company was capitalized in part with a parent guaranty of a fixed amount, invested significant amounts of its capital in treasury stock of the parent and 2/3rds of the risks were attributable to one subsidiary. Notwithstanding the parental guarantee and the related party investment, a majority of the court concluded that the insurance company was not a sham, and that the amounts paid to the insurance company were deductible by the insured subsidiaries as insurance premiums under IRC §162 based on a traditional analysis of insurance risk, risk shifting and risk distribution, and insurance in the commonly accepted sense. Five judges dissented from these conclusions.

The opinion in *Rent-A-Center* is a favorable development for companies with captive insurance programs or considering them. Although the case could be appealed, the release of the opinion could alter the dynamics of ongoing examinations and appeals of captive insurance arrangements where the taxpayer has 1) a fixed parental guarantee, 2) has risk concentration in one or more subsidiaries or 3) has invested in related party investments and could improve the likelihood of success. In addition, the opinion makes clearer the weight the Tax Court accords factors that determine whether an arrangement qualifies as insurance for tax purposes and whether payments are deductible as insurance premiums.

The takeaway

Companies with captive insurance programs, and companies considering such programs, should discuss this development with their tax advisors.

Let's talk

For a deeper discussion of how this issue might affect your captive, please contact:

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