

CAPTIVE INSURANCE COMPANY REPORTS

More on Captives and Last Year's Midterm Election

March 2019

Editor's Note: In the January 2019 issue, we heard from captive experts about their view on how changes in the makeup of the US government might impact captive insurance in "[The Midterm Elections—Thoughts from Captive Leaders and Thinkers](#)." Our accountant friends at Crowe, Daniel Kusaila and Leah McQueeny, now offer their views on the midterm elections and its possible effects on captives. They can be reached at Daniel.kusaila@crowe.com and leah.mcqueeney@crowe.com.

Questions remain about how last year's midterm election results will affect the captive insurance industry and whether the changes, if any, in the legislation surrounding captives will be positive or negative. It remains to be seen how the legislative changes might affect captive growth and continuity. Following is a summary of last year's midterm results and what the changes could mean for captives.

The House

The midterm elections resulted in a power shift in the US House of Representatives, with the Democrats gaining 40 seats to end up with 235 total seats and Republicans with 199 seats.¹ The shift in the House is significant as Republicans now are hindered in their

ability to swiftly pass legislation through the Democratic-controlled House.

The Democratic Party majority in the House supports captive Democratic leaders, such as Vermont's Senator **Patrick Leahy** and Congressman **Peter Welch**. This support might have a positive impact on captive domiciles and leaders that have been working to gain clarification on legislation that inadvertently affected captives, such as the Nonadmitted and Reinsurance Reform Act. In addition, popular captive domiciles including Utah, Nevada, and South Carolina each flipped one seat to a Democrat, which could only further assist Democratic leaders searching for support with clarifying legislation.

The Senate

Unlike the House, the US Senate had only a few seats change between parties and re-

¹"U.S. House Election Results 2018," *New York Times*, January 28, 2019.

mains a Republican majority. With the partisan majorities at odds, new legislation is expected to be met by gridlock. For Republicans, maintaining control of the Senate is important so that they can ensure that recent changes led by the party will not be overturned, including the Tax Cuts and Jobs Act (TCJA), which has many rules going into effect in 2019.

Clarification on Tax Reform

With the possible gridlock between the House and the Senate, major changes in the laws affecting captives are not anticipated. However, clarification of the tax reform laws that passed last year is expected to preoccupy **Charles Rettig**, the new Internal Revenue Service (IRS) commissioner. In addition to guidance on tax reform, technical corrections are needed to address the unintended consequences of the TCJA. These corrections may be difficult to pass, however, with the split in the House and Senate. Some of the items insurance companies are seeking technical corrections and guidance on include the following.

- The global intangible low-taxed income tax
- Whether claims payments made to foreign affiliates would be subject to the base erosion and anti-abuse tax
- Net operating losses for mixed consolidated returns
- The new method of computing the tax loss reserve discounting
- The meals and entertainment disallowance changes

The Joint Committee on Taxation released the blue book, which provides explanations of the enacted tax legislation, at the end of December. The release is a much-anticipated holiday gift to many companies and tax practitioners,

though it will take some time to evaluate what impact the blue book will have on the industry. Other forms of guidance may come from IRS regulations and notices issued by the US Department of the Treasury and in conjunction with the new commissioner.

New IRS Commissioner

While there is still uncertainty about what Mr. Rettig's views will be regarding the captive industry, it is anticipated that he will be engrossed in clarifying the implementation of the TCJA, which goes into effect for the 2018 tax return year. While it is not expected that much attention will be given to the captive insurance industry, a few highly anticipated outstanding captive court cases are expected to be finalized.

Recent Court Cases

Over the past several years, high-profile, small captive cases, including *Avrahami v. Commissioner*, 149 T.C. No. 7 (2017), and *Reserve Mech. Corp., f.k.a. Reserve Cas. Corp. v. Commissioner*, T.C. Memo 2018-86, have left many open questions. Further guidance is expected via the impending results of court cases for small captives, including *Caylor Land & Development, Inc. v. Commissioner of Internal Revenue*; *Wilson v. Commissioner of Internal Revenue*; and *Syzygy Insurance Co. Inc. v. Commissioner of Internal Revenue*. Important questions captives hope to have answered include whether a pool is operating as an insurance company, if claims are being paid properly, if there are enough entities for risk distribution, and how many exposure units are enough.

What's To Come?

Last year's midterm election results may have brought about concerns over new un-

knowns for the captive insurance industry, but the expected gridlock between the House and the Senate, as well as the focus on tax reform, likely will prevent any legislation—with positive or negative implications—from being passed for the industry. Additionally, Mr. Rettig is likely to be too preoccupied with

TCJA changes to be able to dedicate attention to the captive industry, regardless of whether he is captive friendly or otherwise. However, one of the wild cards is how the new senior Democrat leaders in the House might be able to help educate Congress on captive insurance issues.

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