In the Spotlight: "Obama: Crack Down On Business, Individual Tax Havens"

When an offshore captive owner sees this headline they are likely to take notice, especially when hearing that domiciles such as the Cayman Islands and Bermuda are being targeted as notorious "tax havens".

Media reports have stated that the so called "crackdown" is intended to make good on Obama's campaign pledges of tax fairness. The business lobby has responded that ending the policy that lets U.S. companies that invest overseas defer federal taxes on the resulting profits is not only unfair but unwise, and will lead to loss of competitiveness for U.S. owned multi-nationals.

The debate will undoubtedly rage on, driven as much by political posturing as sound economic policy motives. Meanwhile, the U.S. owner of an offshore captive needs to know the two following key facts:

1. The Obama tax fairness initiative is currently targeted at "foreign source income" meaning income earned from business transactions outside of the U.S. Income in the ICS managed group captives is U.S. source income. It comes from insuring risks within the U.S.
2. Because the income earned in the ICS managed group captives is U.S. source income, it is taxable income in the period earned. Tax is paid either by the captive itself or by U.S. shareholders.

Based on these two facts, it is safe to conclude that the proposed crackdown does not apply to U.S. owned and controlled group captives, which may be tax efficient, but are not tax shelters. At significant risk, however, are the rental cell and group captives that operate as non controlled foreign corporations ("NCFC"). Tax experts are generally of the opinion that the days when an NCFC cell captive could be promoted as a tax shelter are gone. The IRS has already stated that in their view, a "cell" is equivalent to a separately incorporated tax payer. If the risks insured or reinsured in the cell generate U.S. source income, that income will be taxable, regardless of who owns the rental captive common stock.

What do we have to watch out for? In spite of the claim that the goal of the Obama tax policy is equity, we also know that it is driven by the need to increase government revenues. Tax experts are of the opinion currently that although dividend tax rates may change, the principle that "double taxation" is wrong will be upheld. In fact, captive owners have always had to be concerned about double taxation, i.e., tax paid first on the income in the captive, and then the same income being subject to tax when it is paid out to a shareholder. For this reason, ICS always recommends that a captive owner consults a tax professional, to ensure that the most tax efficient ownership structure is selected.

Risk Management Focus: FIGHTING FRAUD – WHAT CAPTIVE OWNERS CAN DO

In 1997 the Coalition Against Insurance Fraud (CAIF), a non-profit, nationwide anti-fraud organization, estimated that in the U.S. the annual cost of insurance fraud in all lines nationwide was at $79.7 billion. Most recently, the National Insurance Crime Bureau (NICB), a non-profit organization supported by approximately 1,000 insurance companies, reported that workers' compensation fraud is the fastest-growing segment of insurance fraud, and estimates that it costs the insurance industry nationwide about $5 billion a year. The down turn in the economy is widely expected to lead to a significant spike in fraudulent WC claims from laid off workers. The focus of this article is therefore WC fraud, and its impact on captive owners and insureds.

New Mandatory Claim Reporting Requirements

Insurance organizations and state and federal agencies have increased their efforts in fraud prevention during the last decade, especially in health care fraud and abuse in publicly-funded programs such as Medicare. Section 111 of the Medicare, Medicaid, and SCHIP Extension Act of 2007 adds new mandatory reporting requirements for workers' compensation, group health plans, liability insurance (including self-insurance), and no-fault insurance. Insurers (including direct writing captives like risk retention groups) and self insureds must register before September 2009. On an ongoing basis, insurers and self insureds will be required to report any closed claims resulting in medical expense payments to a person who is a beneficiary under Medicare, including those within an insured's deductible. (Self insureds who are looking for more information about their reporting requirements should refer to the CMS web-site http://www.cms.hhs.gov/MandatoryInsRep/ or consult with their TPA.) The TPA's working with the Innovative Captive Strategies' captives will all comply on behalf of the carriers with these requirements and will ensure that the reporting is completed.

While these new claim reporting requirements seem onerous, and are likely to lead to increased insurer operating costs, it is easy to see why they are considered necessary. Fraud is perpetrated throughout the insurance system and costs insurance users and tax payers significant amounts of money.

WHAT CAN CAPTIVE DIRECTORS DO? Since they represent both the insureds and owners of an insurance company, captive directors have a unique responsibility and opportunity to fight any type of insurance fraud that might impact the value of their captive.

The first step involves increasing the Directors' awareness and understanding of fraud in the workers' compensation system. The main sources (in no order of importance) are:

- **Workers** who receive improper benefits through intentional deception;
- **Health care providers and attorneys** who bill for services not rendered, misrepresent their services, receive kickbacks for referrals and/or contribute to a worker receiving improper benefits (both too much or too little);
- **Employers** who avoid payment of proper insurance premiums, often to gain a competitive advantage in the marketplace;

- **Insurers** who manipulate insurance premiums to avoid proper payment of regulatory costs shared by all insurers (and passed on to insureds in premiums).

An increasing number of U.S. domiciles require insurance companies providing coverage in their state to pass anti-fraud policies that explain their policies to detect and prevent these and other sources of fraud. For example, because in some states workers' compensation laws have given the designated treating physician unprecedented levels of authority and autonomy in controlling the type and duration of medical treatment, providing an open invitation to unscrupulous medical providers bent on committing fraud, many insurers and/or Third Party Administrators have adopted policies requiring a review of the treating physician's evaluation.

A second recommendation easily implemented by captive owners is increased measures to inform injured workers of their rights and responsibilities, and of the penalties for fraudulent activities. Such advisories should be included in informational material about workers' compensation designed for distribution to injured workers. Many state insurance departments have fraud-fighting posters and other materials available on request to employers. Workers need to be constantly reminded of prohibitions and penalties against fraud, and educated so that they understand how fraud hurts everyone. There is widespread recognition that publicizing anti-fraud activities is effective as a deterrent, and some loss control experts recommend increasing public awareness of enforcement activities, arrests, convictions, and savings to all when fraud perpetrators are caught.

Finally, there has to be a process whereby suspected fraudulent activities can be reported, with "whistleblower protection" for the party that provides reliable information, as well as clear penalties for disgruntled employees that make intentionally fraudulent reports. Support for all of these and other measures can be encouraged by the adoption by a captive board of a formal "anti-fraud" policy. Captive owners will not be able to prevent the widely anticipated increase in fraudulent claims on a nationwide basis, but they most certainly can work with their brokers, claims adjusters and fronting carriers to establish policies and procedures to protect their own insurance company.

ICS NEWS

Kate Westover – Vice President of Alternative Risk Financing for ICS, recently received the highest captive award and recognition from CICA, ***The Distinguished Service Award.*** Congratulations to Kate on a well deserved recognition!

2009 Captive Owners' Conference Update – Thanks to everyone who has registered for the conference, we have once again exceeded even our own expectations with 350 of the best customers anywhere joining us in Ireland for Board of Directors Meetings and our "GO GREEN" conference this year. Although the Shelbourne is officially "sold out" we are still taking reservations for those of you who want to register! Be sure to go to our website and register for the conference and then contact Stacy Rosonke at 515-223-6947 or srosonke@yourcaptive.com for information on hotels.

Spring Board Meeting Savings – ICS's goal is always to run productive and informative board meetings for our captive owners. Economic conditions dictate watching every penny and ICS has increased the level of work to watch all expenses associated with Board Meetings. We have launched an initiative to help run more efficient meetings by providing a cost savings analysis to the captive executive committees at the conclusion of each board meeting. Outlined in the analysis are the captive budget savings made through hotel contracting, planning and providing an on-site event coordinator. We are happy to report that for your 2009 Spring Board Meetings (representing six group captives), collectively you saved a total of $62,013.17! ICS will continue to work diligently to provide these savings to our captives!

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