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New Rules for 831(b) Captive Insurance Companies

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On December 18, 2015, Congress passed the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act), as part of a 2016 appropriations bill. The PATH Act includes significant changes to Internal Revenue Code section 831(b). Section 831(b) currently allows captive property and casualty insurance companies with $1.2 million or less in premium income to make an election to be taxed only on investment income and not on its insurance underwriting income.

The PATH Act makes two major changes to Section 831(b), which will become effective January 1, 2017.

First, the $1.2 million premium limit will increase to $2.2 million and will be indexed to the Consumer Price Index. Second, to make and maintain an 831(b) election, an insurance company must meet one of two alternative tests for each year in which it is taxed under Section 831(b). The alternative tests are explained below:

- To meet the first test, a diversification test, no more than 20% of the insurance company's premiums can come from any one policyholder. A broad definition of 'policyholder' applies so that affiliated companies and individuals would be within the definition. Affiliates will be treated as one policyholder for this diversification test.
- The second test, an alternative to the first, essentially requires that ownership of insured businesses and assets mirror (within a 2% de minimis margin) ownership of the insurance company. One purpose of the second test is to prevent an irrevocable trust or other estate planning vehicle set up by the insured company's owners from having an ownership interest in a captive, which can have the effect of transferring wealth from the company's owners to their descendents without paying estate taxes.

There is no language in the recent amendments that grandfathers existing captives, and no such legislation is anticipated. Owners of existing 831(b) captives and businesses and assets insured by 831(b) captives should review their ownership structures to determine whether the captive and insured businesses meet the new "mirror ownership" requirement. If they do not, it may be possible **during 2016** to restructure the ownership of the captive and/or the insured businesses and assets to ensure continued eligibility for the benefits of Section 831(b). **Captive owners should pay particular attention if there are estate planning strategies intermingled with the captive ownership structure.**

For more information contact Bill Harvey or Brian Kahle.