

# CAPTIVE INSURANCE COMPANY REPORTS

## Delaware Guidance on PATH Act Ownership Changes

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*Editor's Note:* We have previously written of the law changes in Delaware. Our friend Jeffrey K. Simpson and his associate Patrick J. Rohrbach, of Gordon, Fournaris & Mammarella, detail those changes in the following article. Mr. Simpson can be reached at [jsimpson@gfmlaw.com](mailto:jsimpson@gfmlaw.com).

In 2015, the Delaware Captive Insurance Association (DCIA) formed a Regulatory Liaison Committee to work with the Delaware Department of Insurance (DDOI) to streamline and improve the regulation and administration of captive insurance in Delaware. Consistent with Delaware's long history of business-friendly regulation and government, DDOI has been meeting regularly and productively with the DCIA Regulatory Liaison Committee.

These meetings, attended by several regulators and a group of captive managers and other industry professionals active in Delaware, have focused on identifying or anticipating regulatory or administrative issues and developing efficient solutions that consider the needs of both industry participants and regulators. These meetings have been fruitful and have resulted

in a flurry of recent regulatory bulletins as well as other changes that include easier forms, simpler processes, and smoother reporting.

With the looming January 1, 2017, effective date of the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act"), the regulatory focus has shifted to anticipating ownership changes that will be made to ensure that certain captives continue to qualify to be taxed as small insurance companies under 26 U.S.C. Section 831(b) (the "831(b) Election"). Among other changes to the 831(b) Election, the PATH Act includes an ownership test (the "Ownership Test") for continued qualification. Intended to inhibit use of captives for wealth transfer, the Ownership Test provides that a spouse or lineal descendant of an owner of an insured business may not hold a greater interest in a captive insuring that business than the spouse or lineal descendant holds in the insured business.

Appreciating that a material number of captives that have taken the 831(b) Election will be affected by the Ownership Test, DDOI has solicited input from the industry and, in Captive Insurance Bulletin No. 6, has provided a

streamlined method for review and approval of these changes. This will enable captives to restructure their ownership to comply with the Ownership Test and thus qualify to continue the 831(b) Election. The benefits are two-fold: (1) captives considering restructuring their ownership will find it convenient to do so and to remain domiciled in Delaware, and (2) the procedures will ease the year-end burden on the DDOI.

The procedures address two likely scenarios: first, a simple transfer of ownership interest, and second, a termination of an existing captive and replacement with a new captive. However, for this purpose, each is treated as a routine change of business plan to ease the administrative burden and offer cost savings to provide an incentive to meet a December 1 filing deadline. Applications after December 1 will still be accepted, but they may not benefit from streamlined treatment or cost savings.

### **Procedure 1—Change Ownership Structure of Existing Captive**

The first procedure involves restructuring the ownership of an existing captive to comply with the Ownership Test. DDOI instructs the requesting captive insurer to submit the following:

- ✓ A revised business plan reflecting the new ownership structure;
- ✓ Biographical affidavits for any new owners; and
- ✓ A written explanation indicating how the new captive insurer complies with the Ownership Test.

Because this is a simple business plan change, no fees are required.

### **Procedure 2—Change Ownership by Forming a New Captive**

As an alternative to restructuring the ownership of an existing captive, the second procedure anticipates the existing captive insurer being wound up and a new captive being formed with different ownership that complies with the Ownership Test. The newly formed captive will require a new tax identification number, a new certificate of authority, and will, of course, have different ownership. In all other respects, the new captive must be identical to the old captive.

This procedure requires the requesting captive insurer to submit the following:

- ✓ A revised business plan reflecting the ownership change;
- ✓ An affidavit from the captive owner indicating that the risks taken by the new captive are identical in character and premium to the old captive;
- ✓ Biographical affidavits for all new owners;
- ✓ A written explanation indicating how the new captive insurer complies with the Ownership Test; and
- ✓ A \$300 application fee for the new license.

Because this will be treated as a change of business plan, the additional \$3,200 that would normally be required as an application processing fee will be waived.

In their anticipatory nature and their reliance on industry input, these procedures are indicative of a business-friendly and customer-centered domicile. It is hoped they represent a developing trend of responsive and cooperative captive regulation. ■

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