



Life Insurance in the Captive Investment Plan

The utilization of life insurance in the captive investment plan has been an evolving issue over the past few years. While there are no issued rulings or guidance from the IRS on this topic, it is clear from recent discussions with tax litigation counsel around the country that the IRS is stepping up its enforcement efforts regarding life insurance as a captive balance sheet investment. At issue is the utilization of traditional high cash surrender value life insurance which is typically funded within a sophisticated estate tax plan. The IRS is focusing on patterns of abuse whereby the captive invests in the cash surrender value of the policy via a split-dollar or assignment agreement, while the death benefit ownership resides in an irrevocable trust outside of the captive and the person's estate.

In the typical scenario, a life insurance agent may promote the use of a captive insurance company as a method to obtain life insurance with tax-deductible dollars. This should never be the reason for implementing a captive insurance company and the optics can be problematic, especially when the client implements a risk management plan and their life insurance estate planning simultaneously. This timing of events can generate IRS scrutiny as to the purpose of forming and implementing the captive. Is the primary purpose of the captive formation risk management or purchasing tax-deductible life insurance for estate planning purposes?

The lines can become blurred even further in instances where the captive manager requires the client to incorporate life insurance in the captive investment plan or charges higher fees if the client declines to utilize life insurance as an asset of the captive.

Further complicating the topic is the fact that insurance regulators in various domiciles may allow the use of certain life insurance policies within the captive investment plan, thus providing insurance regulatory approval of the practice. Arguably, there can be numerous reasons which logically support the use of certain life insurance contracts as an attractive investment class, including safety of principal, contractual guarantees, relatively attractive rates of return, etc. However, given the current tax climate, it seems logical to simply avoid the use of life insurance products in captive investment plans.

At the present time, Oxford Risk Management Group's investment policy does not allow for traditional life insurance as a direct investment option or indirectly via split-dollar and assignment agreements. The investment policy of a captive should be concentrated on liquidity and income producing assets, consistent with prudent and conservative investment portfolio guidelines.