

# Competing For Captives: What Regulatory Competition Can Teach About Tax Competition (Guest Blogger Dr. Andrew Morriss)

Kluwer International Tax Blog  
July 25, 2015

William Byrnes (Texas A&M University Law)

Please refer to this post as: William Byrnes, 'Competing For Captives: What Regulatory Competition Can Teach About Tax Competition (Guest Blogger Dr. Andrew Morriss)'; Kluwer International Tax Blog, July 25 2015.  
<http://kluwertaxblog.com/2015/07/25/competing-for-captives-what-regulatory-competition-can-teach-about-tax-competition-guest-blogger-dr-andrew-morriss/>

Dr. Andrew P. Morriss is Dean & Anthony G. Buzbee Dean's Endowed Chairholder, Texas A&M University School of Law; Drew Estes is a JD/MBA Candidate, Class of 2016, University of Alabama. Excerpted from Kluwer CCH's Global Tax Weekly Magazine

## Introduction

Tax competition is usually portrayed as a competition over rates. Critics argue that such competition leads inevitably to a "race to the bottom," with the result of reducing tax rates and revenue everywhere. They also decry "secrecy" jurisdictions that allow owners of entities to conceal their identities, suggesting that the only reasons for confidentiality can be to cheat tax authorities somewhere out of their due. But as anyone who has ever filled out a tax return knows, tax rates are just one facet of tax competition. Jurisdictions can compete over a wide range of tax system attributes – all the way from the complexity of the system to special provisions designed to advantage particular forms of investment to general depreciation rules. Lower rates can attract taxpayers, but allowing more rapid depreciation of capital investment might trump lowering rates for capital-intensive industries, while an honest and efficient revenue agency may matter more than nominal rates for total revenue collections. For example, many of Greece's revenue problems do not stem from low rates but from a failure by taxpayers to pay what they owe and a failure of tax authorities to collect taxes owed. To examine how regulatory competition works, we can step back from tax and look at a recent example of such competition in the US captive insurance market by the state of Georgia.

## Competition For Captives

Captives (insurance companies owned by their insureds) provide a variety of advantages in many industries. For example, many health care providers have created captives to control the coverage available to their doctors, to avoid the vagaries of the medical malpractice insurance market. In addition, having a separate entity that acts as an insurance company allows access to reinsurance markets. Once a firm has decided to create a captive, it needs a jurisdiction in which to create the entity that will act as its insurer. Jurisdictions compete for this business, since the captives pay fees to their host jurisdictions and require services from accountants, lawyers, insurance managers, and other professionals, creating high quality employment within the host jurisdiction. How do jurisdictions compete for this desirable business?

All captive domiciles are not equal. Some heavy-hitter captive domiciles aggressively market their jurisdictions as captive paradises, and rightly so. For example, Vermont and Utah offer the latest risk-financing tools (e.g., special purpose captives, protected cell captives, branch captives, etc.) at competitive prices, as well as knowledgeable and attentive captive regulators. The combination of low fees and a high quality regulator make the total cost of creating and operating a captive lower. As a result, they boast thriving captive industries, in terms of both professionals and captives. On the other hand, many captive domiciles are *de jure* domiciles only. Their captive statutes are outdated and, as a result, there are few captives registered and their insurance regulators lack expertise with captives.

## Georgia's Increased Competition

A recent entrant into the captive market is Georgia. While it does not (yet) offer the latest risk-financing tools, it does have knowledgeable captive regulators and plenty of captive professionals. Consequently, it currently has nine captives, placing it in the middle of the pack among domiciles. In an effort to improve its position, Georgia recently updated the Georgia Captive Insurance Company Act with the passage of House Bill 552 ("HB 522"). This update was the product of a joint effort by Georgia's Department of Insurance and a reinvigorated Georgia Captive Insurance Association.

HB 522 is a significant leap forward for Georgia's captive industry in a number of ways. For one, it significantly enhanced confidentiality by providing that all documentation "reasonably designated confidential" by a "pure" captive (a captive insuring or reinsuring only the risks of its parent and affiliates) "obtained by or submitted or disclosed to the Commissioner pursuant to [the Georgia Captive Insurance Company Act] ... shall not be subject to subpoena ... [or] made public." Second, HB 522 cut the capital requirements for "pure" captives in half, from USD500,000 to USD250,000. More importantly, however, HB 522 relieved Georgia captives from paying the general insurance premium tax rate of 2.25 percent and substituted a competitive premium tax rate of 0.4 percent on the first USD20m of direct premiums and 0.225 percent on the first USD20m of assumed reinsurance premiums without imposing a minimum premium tax. HB 522 did not create provisions for sponsored, branch, or special purpose captive insurance companies. Georgia also does not have dedicated funds to finance a captive division within Georgia's Department of Insurance, due to state constitutional restrictions. (We've previously identified this as a key factor in the current market leader jurisdictions' success.)

According to Doug Butler and Anthony "Tony" Roehl, captive professionals intimately involved in the drafting and passage of HB 522, Georgia's current goals are quite different than those of domiciles like Vermont and Utah. Georgia recognized that captives have become a keystone of many corporate families' risk-financing toolkit. Consequently, a business considering a move to Georgia must consider the effect such a move would have on its captive. By enhancing Georgia's captive regulatory structure and bringing more business to the state, Georgia hopes to lure more businesses to the state. In particular, dealing with knowledgeable regulators and professionals nearby is a significant advantage, since it reduces the corporate family's compliance costs if an issue arises with the captive. More significant, however, is the avoidance of self-procurement taxes. With self-procurement taxes almost ubiquitous across jurisdictions, domiciling a captive within the domicile of its corporate family's principal place of business has significant tax advantages. In Georgia, for instance, the self-procurement tax is 4 percent when using an out-of-state captive to insure the risk of an entity headquartered in Georgia. Avoiding this tax by re-domiciling the corporate family's captive in Georgia will cut the corporate family's overall tax burden.

Georgia's efforts do involve cutting tax rates – but they also involve much more. Georgia recognized that having a regulator that kept costs down by building expertise was important. And it saw that bringing businesses to Georgia by facilitating modern business techniques like the use of captives as a risk management tool was a key to the state's overall economic growth. That growth will, in turn, bring in more revenue to the state. Georgia's new captive provisions thus sacrifice the revenue from the self-procurement tax on premiums paid to out-of-state domiciled captives for a lower rate applied to purchases from Georgia-based captives. One could thus argue that Georgia has done just what the opponents of tax competition argue happens in a race to the bottom: cut tax rates and increased confidentiality.

## A Means To A Larger End

That's not quite the entire story, however. Georgia's captive goals are a means to a larger end: attracting business. Having an up-to-date captive statutory and regulatory framework is a necessary ingredient when courting businesses from outside the state. This is significant in several ways.

First, it illustrates the importance of the captive industry to businesses and, thus, the economy as a whole. Businesses are now demanding that domiciles offer an up-to-date captive regulatory framework at competitive prices. In other words, the captive industry's needs have become a necessary consideration in domicile competition. As a result, the captive industry's leverage with legislatures and regulators is increasing as captives become more entrenched within the business community. The industry's needs can no longer be viewed in the limited context of what the captive industry itself means to the domicile. Rather, its needs must be viewed within the broad context of the domicile's efforts to attract businesses generally. This should lead to better service from both legislatures and regulators.

Second, Georgia's efforts mean increased competition for the current top domestic captive domiciles like Vermont and Utah. As more domiciles attempt to enter the market, there will be more options for captive professionals and corporate decision makers. Some of that competition will aim at quality. But the self-procurement tax issue offers jurisdictions with large numbers of businesses located in them an opportunity. Domiciles such as Texas, for example, could change the national competitive playing field by imposing high self-procurement taxes for Texas-based entities buying insurance from non-Texas domiciled entities.

The key point is that Georgia's efforts illustrate how jurisdictions trade off along different margins in an effort to improve their overall welfare. Forgoing some self-procurement tax revenue and spending more on its insurance regulator will bring Georgia (or so it hopes) more businesses domiciled there. That will increase business for Georgia accountants, lawyers and insurance managers (which will yield profits Georgia can tax). It will make growing a business (and so growing profits that can be taxed there) easier. Georgia thus hopes that reducing the costs of Georgia captives will ultimately boost its opportunities for state revenue, as well as increasing the well-being of Georgia residents employed by the businesses it lures to locate in Georgia.

Critics of tax competition often point to lowered tax rates on businesses as evidence of a "race to the bottom." But as this example shows, the competition among jurisdictions occurs across multiple margins. Picking out a single margin for analysis misses the bigger picture. Doing a dynamic policy analysis along multiple margins is much harder, and much less likely to yield a headline screaming that billions in revenue have been lost to tax authorities. It is less likely to help anti-competition NGOs raise donations. But unless we get the policy debate right, we'll miss out on the opportunities competition, whether in captive insurance regulation or tax policy, offers for promoting economic growth.

For Dr. Andrew Morriss' full article, see [Kluwer CCH's Global Tax Weekly Magazine](#)