Tax Court Upholds Captive Insurance Arrangement Despite Parent Guarantee and Captive’s Investment in Stock of Parent

The Tax Court recently released its long awaited captive insurance decision in Rent-a-Center v. Commissioner. In this case, the Internal Revenue Service argued that a guarantee from Rent-a-Center (“RAC”) to its wholly-owned captive insurance subsidiary Legacy Insurance Co., Ltd. (“Legacy”) and Legacy’s investment in non-dividend paying treasury stock of RAC meant that amounts paid by RAC’s 15 affiliated subsidiaries (collectively, “Taxpayer”) were not deductible insurance expenses under section 162 of the Internal Revenue Code of 1986, as amended.

RAC formed Legacy to better manage its risks and to decrease costs. Legacy insured Taxpayer’s workers’ compensation, automobile, and general liability claims below a threshold amount. Claims in excess of the threshold amount were insured by an unrelated insurance company. Legacy primarily invested the premiums in non-dividend paying treasury stock of RAC.

In a divided Tax Court opinion, the majority concluded that RAC’s guarantee to Legacy, by itself, did not prevent this captive insurance arrangement from constituting insurance. Furthermore, the majority did not question Legacy’s investment in non-dividend paying treasury stock of RAC. As a result, the Tax Court held that the amounts paid by Taxpayer were deductible as insurance expenses because insurance risks were shifted from the Taxpayer to Legacy, Legacy distributed those risks and the arrangement was insurance in the commonly accepted sense.

To discuss this issue further, please speak to your Bryan Cave contact, or to:

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