

## Interview with an Icon: Tom Jones



In the second of our series of “interviews with an icon” 180° talks with Tom Jones, Partner at McDermott Will & Emery LLP. Tom has been active in the captive industry for 25 years. He is a leading expert on taxation, legal and regulatory issues affecting captives and their owners.

### **180: How did you get started in the captive industry?**

**TJ:** I started my legal career with McDermott in 1975 as an interna-

tional tax attorney working on a wide range of corporate tax and legal matters for taxable entities.

My captive work started in 1984 with a Cayman hospital captive. From then on I started doing more and more captive work, especially for non profit and other healthcare captives. In the early 1990s I also started focusing on taxable company captive issues and from the mid 1990s I have focused almost exclusively on captives and their owners.

### **180: How do you view the current tax environment for captives?**

**TJ:** The tax framework for captives and their owners is better now than has ever existed before. The key issues are pretty clear. At least the analytical framework of this positive environment exists because certain taxpayers have been willing to take on the IRS in court. Over the decades the IRS has tried to establish the law by issuing administrative orders, revenue rulings etc. that are not supported by statutes and case law. These IRS initiatives have been followed by lawsuits where one or more taxpayers challenge the IRS. For the most part the taxpayers have prevailed, thus restarting the cycle. If lawsuits such as Humana and Sears had not been heard and won, the captive market would be far smaller than it is today.

### **180: What changes have you seen in how the IRS approaches captives?**

**TJ:** There is no coordinated or “standard cookbook” approach that applies anymore to captives. Every case is based on fact and circumstances with no consistent approach in the field. The result is that some field agents focus on random issues that can be somewhat “off the wall”. This is not necessarily a bad thing but it just means it’s harder to predict how the IRS will view a particular captive arrangement or set of facts.

### **180: What changes have you seen in the industry in general?**

**TJ:** The level of professionalism is much greater than the “good old days”. As the industry has matured it has attracted smarter, more qualified people who have learned from the mistakes of the past.

People make the difference – the captive industry is an amazingly supportive atmosphere in which the participants are willing to share knowledge on a collaborative basis. It has attracted a lot of diligent, honest, entrepreneurial individuals over the decades who are not

only in it for the money. Loss prevention and mitigation are the overriding concerns.

### **180: What future changes do you see in the tax environment**

**TJ:** The next big issue on the horizon is refining the definition of risk distribution. The IRS position that the only way to achieve insurance treatment is to pool the risks of numerous corporate legal entities or unrelated parties is bound to be challenged because fundamentally there are many other ways to achieve economic risk distribution.

The IRS is currently focusing on cell captives and appears to be leaning towards treating every cell as a separate taxpayer. It is an open question whether any changes will be prospective or retrospective. More direction and clarity will be positive for cell captives in the long term.

Captives are also likely to be impacted by future changes in tax policy. Falling corporate tax rates to match other industrial countries will make pass through (e.g. multiple LLC) structures less attractive to family businesses. This should be a helpful fact pattern for captives. Closely held businesses will be moving back to consolidated corporate groups and away from complicated families of LLCs which currently hinder brother - sister arguments. The current economic environment has already hurt several industries – auto dealers, real estate developers/managers, construction companies that have been active owners and users of §831(b) captives.

### **180: What changes do you see in the captive industry generally?**

**TJ:** Captives are now mainstream. They are no longer an afterthought to most companies’ risk financing and insurance strategy. Captives will become more integral and sophisticated financial vehicles. Tax is just part of the equation and is not the main driver for most companies.

The use of captives for employee benefits is rapidly expanding and here to stay. This segment of the industry is finally achieving critical mass and demonstrates yet another reason companies are growing their captives.

I am optimistic about the future. Captives have largely out maneuvered the traditional commercial insurance industry over the past 30 years. If the traditional market would have been more flexible, captives would not have been so successful.

### **180: What concerns if any do you have for the future?**

**TJ:** More insurance regulation. If the entire insurance industry becomes subject to federal regulation, captives could be swept up and adversely impacted. A “one size fits all” type of regulation simply doesn’t work for captives.

Anti-tax haven legislation could adversely impact offshore captives. Not for profit healthcare captives in particular are vulnerable because they do not have a dedicated common trade association or voice to represent and protect their interests.

### **180: A final comment..**

**TJ:** The great thing about captives is the fundamental fact that the owners know the underlying risks being funded better than outsiders. This is a sustainable advantage in contrast to commercial insurance companies that don’t encounter these risks on a daily basis.