

Testimony of Jason Schupp - Unfavorable

SB 890 – Insurance - Captive Insurers - Premium Receipts Tax Moratorium and Study

I am a Frederick County resident, having grown up in Hagerstown and graduated from University of Maryland School of Law. Since I retired as head of Compliance for one of the world's largest insurance groups at the end of 2019, I have been researching the secretive world of captive insurance companies. During this time, I have compiled a database of more than 10,000 captive insurers domiciled in 81 jurisdictions throughout the world.

The Moratorium

Through this research, I have come to identify three kinds of captive owners:

1. Those that dutifully pay their state premium taxes.
2. Those that pay up after they get a letter from me or a tax authority.
3. Those that kick and scream when they get caught.

Maryland's hospitals fall into this third category. Through my investigation of offshore for-profit captive insurance companies owned by Maryland's hospitals, I have learned:

- Cayman Islands captive insurance companies affiliated with hospital systems in Maryland hold more than \$3 billions dollars in offshore accounts.
- Maryland hospital systems have transferred more than \$650 million - perhaps far more - in taxable premium to the Cayman Islands over the last 5 years alone.
- These Cayman Islands captives have shorted Maryland taxpayers **at least \$20 million** in premium tax over the last five years – a number that may grow exponentially once the hospitals allow an audit of their financial records.
- The hospitals classify their transactions with their Cayman Islands captive insurers as “insurance” in their financial statements, issue “certificates of insurance” based on these transactions, report these arrangements as “insurance” to the Maryland Board of Physicians, and receive contracts entitled “policy of insurance” from their captive insurers.
- Solely in the context of tax do the hospitals claim their Cayman Islands licensed insurers do not provide “insurance”.
- The Cayman Islands captive community has been advised by lawyers and auditors through, among other sources, the Cayman Islands Captive Forum since at least 2012 that state premium tax is due on these transactions.
- The boards of directors of these Cayman Islands insurance companies are stacked with a who's who of Maryland hospital executives including at least a half-dozen hospital system CEOs and many other of their C-suite executives.

Maryland's hospitals could settle their tax liabilities today with the State of Maryland for the cost of less than 1% of the treasure they have buried in the Cayman Islands.

The Study of Captive Insurers

Scandals involving hospital systems and their Cayman Islands captive insurance companies have been roiling the healthcare industry for years:

- The [Boston Globe found](#) that Steward Health Care had “had emptied [its Cayman Islands captive’s] coffers by withholding premium payments and by replacing various assets with IOUs that may now, given Steward’s financial cratering, have little or no value”.
- In New York, [several hospital systems worked together](#) to on a scheme designed to “hide the surplus funds from state regulators and ensure that its owners, meaning the hospitals, received dividends from [the Cayman Islands captive insurance company]”.
- [Nurses in Massachusetts](#) has been at the forefront of calling on that state’s nonprofit hospitals to disclose their offshore captive insurance accounts through “legislation requiring financial transparency from hospitals and the returning of excess profits and CEO pay to the public good”.

In addition to hiding hundreds of millions of dollars, nonprofit hospitals have found ways to use their Cayman Islands captives to lavish their top executives in luxury:

- [An investigation in Illinois](#) found that a hospital board member, also a state legislator, had been on the payroll of a hospital’s Cayman Islands captive insurance company and enjoyed stays at a luxury Cayman Islands hotel.
- A [nonprofit hospital in Long Island](#), New York had been sending its executives on 2 week annual excursions to visit its Cayman Islands captive until the scandal forced the hospital to forbid future travel to the Cayman Islands.
- One news organization was able to obtain [credit card statements](#) from a Cayman Islands captive insurance company owned by a Georgia hospital. The credit card had been used to make “tens of thousands of dollars in charges over the last three years on airfare, five-star hotel stays and fancy restaurants in the Caymans, Puerto Rico and the Bahamas.”

Onshore and offshore captive insurers have been implicated in a range of other abuses outside of hospital systems:

- The IRS has included certain captive insurance arrangements in its [Dirty Dozen Tax Scams](#) for years. These so-called “micro-captives” can be misused to create phantom business expense deductions on Maryland corporate income tax returns.
- Maryland recently lost \$24 million in tax, penalties and interest in just one [captive insurance scheme](#). From 1996-2003, Macy’s captive insurance company earned \$2 billion in interest on loans to Macy’s stores - including those in Maryland - while earning only \$52 million in insurance premium. Ultimately, the Appellate Court of Maryland ruled that the captive was wholly exempt from Maryland’s corporate income tax - even for business activities that have nothing to do with insurance.
- An [investigative journalist](#) in Oregon found that a local sewer board set up a captive insurance company in Hawaii which it used to fund stays “at an assortment of five-star resorts across several islands offering breathtaking views of the beach and ocean” for board members, including “first-class airfare, premium hotel rooms or fine dining”. Just three such trips cost ratepayers \$91,000.
- A California agency responsible for helping public schools purchase insurance also created a captive insurance company in Hawaii. An audit discovered a [secret off-the-books \\$8 million fund](#) held by the captive insurer. The auditor reported that its “questions regarding the agency’s creation of [the captive] and [two agency executives’] service on that board were shut down by ASCIP’s legal team, which stated the captive was an entity separate from the joint powers authority”.

I am committed to assisting the Comptroller, the Maryland Insurance Administration, the Department of Health and any other interested agency to expose the abusive use of captive insurance in Maryland, regardless of any legislatively mandated study.

The Comptroller, the MIA, and the Department of Health already have the tools they need to get to the bottom of captive insurance misuse and abuse in Maryland.

For these reasons, the Committee should issue an unfavorable report on SB 890.

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Key Maryland Statutes

Md. Ins. Code § 4-209(b)(1) – Premium Receipts Tax

If an unauthorized insurer effects, continues, or renews insurance on a subject resident, located, or to be performed in the State, the unauthorized insurer shall pay to the Commissioner, before March 1 of the next calendar year, a premium receipts tax of 3% of gross premiums charged for the insurance.

Md. Ins. Code § 1-101(s) – Definition of Insurance

Except as expressly provided otherwise in this article, “insurance” means a contract to indemnify or to pay or provide a specified or determinable amount or benefit on the occurrence of a determinable contingency.

Md. Health Occ. Code § 14-508 – Notification of Uninsured Status

Each licensee practicing medicine in the State shall notify a patient in writing if [the] licensee does not maintain medical professional liability insurance coverage.... Each licensee practicing medicine in the State who does not maintain medical professional liability insurance coverage shall post this information in a conspicuous location in the licensee’s place of practice.

Md. Health Occ. Code § 14-312 – Evidence of Insurance

On request of the Board, a physician who reports to the Board that the physician maintains medical professional liability insurance for purposes of the public individual profile maintained by the Board under § 14-411.1(b) of this title shall provide the Board with verification or other documentation that the physician maintains the insurance within 25 business days after the physician receives a request from the Board.