Part III – Administrative, Procedural, and Miscellaneous

Listed Transactions and Transactions of Interest

Announcement 2023-11

The identification of “listed transactions”—transactions that the Internal Revenue Service (IRS) has determined to be abusive tax avoidance transactions within the meaning of § 1.6011-4(b)(2) of the Income Tax Regulations—and “transactions of interest”—transactions that the IRS has determined have the potential for tax avoidance or evasion within the meaning of § 1.6011-4(b)(6)—is an important tool in combatting the use of abusive tax avoidance transactions. Since 2000, the IRS has identified more than 30 of these transactions by publishing a notice or other subregulatory guidance as provided in § 1.6011-4. One of these notices, Notice 2016-66, 2016-47 I.R.B. 745 (as modified by Notice 2017-8, 2017-3 I.R.B. 423), identified certain micro-captive transactions as transactions of interest.

Recent court decisions have held that the IRS’s longstanding practice of issuing notices to identify listed transactions and transactions of interest does not comply with the Administrative Procedure Act (APA), 5 U.S.C. 551-559. On March 3, 2022, the U.S. Court of Appeals for the Sixth Circuit issued an order holding that Notice 2007-83, 2007-2 C.B. 960, which identified certain trust arrangements as listed transactions, violated the APA because the notice was issued without following the notice-and-comment procedures required by section 553 of the APA. Mann Construction v. United States, 27

F.4th 1138, 1147 (6th Cir. 2022). Subsequently, the U.S. District Court for the Eastern District of Tennessee, which is located in the Sixth Circuit, vacated Notice 2016-66 on the ground that the IRS failed to comply with the APA's notice-and-comment procedures, viewing the analysis in Mann Construction as controlling. CIC Services, LLC v. IRS, 2022 WL 985619 (E.D. Tenn. March 21, 2022), as modified by 2022 WL 2078036 (E.D. Tenn. June 2, 2022). The Court also held that the IRS acted arbitrarily and capriciously, based on the administrative record. On November 9, 2022, the U.S. Tax Court, in a reviewed decision with two judges dissenting, relied on Mann Construction in holding that Notice 2017-10, 2017-4 I.R.B. 544, which identifies certain syndicated conservation easements as listed transactions, is invalid because it was issued without following notice-and-comment rulemaking procedures. See Green Valley Investors, LLC v. Commissioner, 159 T.C. No. 5 (2022). See also Green Rock, LLC v. IRS, 2023 WL 1478444 (N.D. AL., February 2, 2023).

The Department of the Treasury (Treasury Department) and the IRS disagree with the recent court decisions holding that listed transactions cannot be identified by notice or other subregulatory guidance. However, the Treasury Department and IRS will no longer take the position that transactions of interest can be identified without complying with APA notice-and-comment procedures. Accordingly, the IRS is obsoleting Notice 2016-66 (as modified by Notice 2017-8), and will not enforce the disclosure requirements or penalties that are dependent upon the procedural validity of Notice 2016-66. Consistent with this determination, the Treasury Department and the IRS are today issuing proposed regulations that identify certain micro-captive transactions as transactions of interest. The proposed regulations also identify certain

other micro-captive transactions as listed transactions.

The Treasury Department and the IRS continue to take the position that listed transactions can be identified by notice or other subregulatory guidance because Congress, in enacting the American Jobs Creation Act of 2004, exempted the identification of such transactions from the APA's notice-and-comment procedure. As stated in Announcement 2022-28, 2022-52 I.R.B. 659 (Dec. 27, 2022), the Treasury Department and IRS will continue to defend existing listing notices in cases in which Mann Construction is not controlling precedent. Consistent with the aim expressed in Announcement 2022-28 of avoiding confusion and preventing disruption of the IRS's ongoing efforts to identify and examine abusive tax shelters, the Treasury Department and the IRS are following notice and comment procedures in identifying certain micro-captive transactions as listed transactions in order to eliminate any confusion and ensure that the IRS's efforts to combat abusive tax shelters throughout the nation continue undisrupted.

The Treasury Department and the IRS intend to finalize these regulations, after due consideration of public comments, in 2023 and intend to issue proposed regulations identifying additional listed transactions in the near future.

Taxpayers should take note that, if a transaction becomes a listed transaction or a transaction of interest after a taxpayer files a tax return (including an amended return) reflecting the taxpayer's participation in the transaction, § 1.6011-4(e)(2)(i) generally requires the participant to file a disclosure statement (Form 8886, *Reportable Transaction Disclosure Statement*) with the Office of Tax Shelter Analysis (OTSA) within 90 days of the transaction becoming a listed transaction or a transaction of interest if the

assessment limitations period remains open for any taxable year in which the taxpayer participated in the transaction. Accordingly, any taxpayer who has participated in a transaction in any year for which the assessment limitation period remains open when the regulation identifying the transaction as a listed transaction or a transaction of interest is finalized will have an obligation to disclose the transaction, unless otherwise provided in the final regulations. Failure to disclose will subject the taxpayer to the penalty under section 6707A of the Internal Revenue Code (Code). Participants required to disclose listed transactions who fail to do so are also subject to an extended period of limitations under section 6501(c)(10) of the Code. That section provides that the time for assessment of any tax with respect to the transaction will not expire before the date that is one year after the earlier of the date the participant discloses the transaction or the date a material advisor discloses the participation pursuant to a written request under section 6112(b)(1)(A) of the Code.

Likewise, if a regulation identifying a transaction as a listed transaction or a transaction of interest is finalized after the occurrence of the events described in § 301.6111-3(b)(4)(i) of the Procedure and Administration Regulations, a material advisor will be treated as becoming a material advisor on the date the regulation is finalized pursuant to § 301.6111-3(b)(4)(iii) (if not deemed a material advisor earlier pursuant to a valid listing notice). A material advisor is required to file a Form 8918, *Material Advisor Disclosure Statement*, with OTSA by the last day of the month that follows the end of the calendar quarter in which the advisor became a material advisor with respect to the transaction. See § 301.6111-3(d) and (e).

In addition, a material advisor must maintain a list identifying each person with

respect to whom the advisor acted as a material advisor with respect to a listed transaction or transaction of interest, if the person advised by the material advisor entered into the transaction within six years before the date the transaction was identified as a listed transaction or transaction of interest in published guidance. See § 301.6112-1(b)(2).

DRAFTING INFORMATION

The principal author of this announcement is Stephanie W. Chernoff of the Office of the Associate Chief Counsel (Procedure & Administration). For further information regarding this announcement, contact Stephanie W. Chernoff at (202) 317-5670 (not a toll-free call).

Proposed Treasury Regulations

IRS Proposed Rules (REG-109309-22, April 11, 2023) on Micro-captive Listed Transactions and Micro-captive Transactions of Interest

Preamble —

IRS Proposed Rules (REG-109309-22) on Micro-captive Listed Transactions and Micro-captive Transactions of Interest

For a PDF version of REG-109309-22 click here.

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-109309-22]

RIN 1545-BQ44

Micro-Captive Listed Transactions and Micro-Captive Transactions of Interest

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that identify transactions that are the same as, or substantially similar to, certain microcaptive transactions as listed transactions, a type of reportable transaction, and certain other microcaptive transactions as transactions of interest, another type of reportable transaction. Material advisors and certain participants in these listed transactions and transactions of interest are required to file disclosures with the IRS and are subject to penalties for failure to disclose. The proposed regulations affect participants in these transactions as well as material advisors. This document also provides notice of a public hearing on the proposed regulations.

DATES: Electronic or written comments must be received by June 12, 2023. The public hearing on these proposed regulations is scheduled to be held by teleconference on July 19, 2023, at 10 a.m. ET. Requests to speak and outlines of topics to be discussed at the public hearing must be received by June 12, 2023. If no outlines are received by June 12, 2023, the public hearing will be cancelled. Requests to attend the public hearing must be received by 5 p.m. ET on July 17, 2023. The telephonic public hearing will be made accessible to people with disabilities. Requests for special assistance during the telephonic hearing must be received by July 14, 2023.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG-109309-22). Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish any comments to the public docket. Send paper submissions to: CC:PA:LPD:PR (REG-109309-22), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

For those requesting to speak during the hearing, send an outline of topic submissions, electronically via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG-109309-22).

Individuals who want to testify (by telephone) at the public hearing must send an email to *publichearings@irs.gov* to receive the telephone number and access code for the hearing. The subject line of the email must contain the regulation number REG-109309-22 and the word TESTIFY. For example, the subject line may say: Request to TESTIFY at Hearing for REG-109309-22. The email should include a copy of the speaker's public comments and outline of discussion topics. Individuals who want to attend (by telephone) the public hearing must also send an email to *publichearings@irs.gov* to receive the telephone number and access code for the hearing. The subject line of the email must contain the regulation number REG-109309-22 and the word ATTEND. For example, the subject line may say: Request to ATTEND hearing for REG-109309-22. To request special assistance during the telephonic hearing, contact the Publications and Regulations Branch of the Office of Associate Chief Counsel (Procedure and Administration) by sending an email to *publichearings@irs.gov* (preferred) or by telephone at (202) 317-6901 (not a tollfree number).

FOR FURTHER INFORMATION CONTACT:

Concerning the proposed regulations, Elizabeth M. Hill of the Office of Associate Chief Counsel (Financial Institutions & Products), (202) 317-4458; concerning the submission of comments or the hearing, Vivian Hayes at (202) 317-6901 (not toll-free numbers) or by email at *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed additions to 26 CFR part 1 (Income Tax Regulations) under section 6011 of the Internal Revenue Code (Code) regarding transactions identified as listed transactions and transactions of interest for purposes of section 6011.

I. Overview of the Reportable Transaction Regime

Section 6011(a) generally provides that, when required by regulations prescribed by the Secretary of the Treasury or her delegate (Secretary), “any person made liable for any tax imposed by this title, or with respect to the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms or regulations.”

On February 28,2000, the Treasury Department and the IRS issued a series of temporary regulations (TD 8877; TD 8876; TD 8875) and cross-referencing notices of proposed rulemaking (*REG-103735-00*; *REG-110311-98*; *REG-103736-00*) under sections 6011, 6111, and 6112. The temporary regulations and cross-referencing notices of proposed rulemaking were published in the **Federal Register** (65 FR 11205, 65 FR 11269; 65 FR 11215, 65 FR 11272; 65 FR 11211, 65 FR 11271) on March 2, 2000 (2000 Temporary Regulations). The 2000 Temporary Regulations were modified several times before March 4, 2003, the date on which the Treasury Department and the IRS, after providing notice and opportunity for public comment and considering the comments received, published final regulations (TD 9046) in the **Federal Register** (68 FR 10161) under sections 6011, 6111, and 6112 (2003 Final Regulations). The 2000 Temporary Regulations and 2003 Final Regulations consistently provided that reportable transactions include listed transactions and that a listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and has identified by notice, regulation, or other form of published guidance as a listed transaction.

Following the 2003 promulgation of § 1.6011-4, Congress passed the American Jobs Creation Act of 2004 (AJCA), Public Law 108-357, 118 Stat. 1418 (October 22, 2004), which added sections 6707A, 6662A, and 6501(c)(10) to the Code, and revised sections 6111, 6112, 6707, and 6708 of the Code. *See* sections 811–812 and 814–817 of the AJCA. The AJCA's legislative history explains that Congress incorporated in the statute the method that the Treasury Department and the IRS had been using to identify reportable transactions, and provided incentives, via penalties, to encourage taxpayer compliance with the new disclosure reporting obligations. As the Committee on Ways and Means explained in its report accompanying H.R. 4520, which became the AJCA:

The Committee believes that the best way to combat tax shelters is to be aware of them. The Treasury Department, using the tools available, issued regulations requiring disclosure of certain transactions and requiring organizers and promoters of tax-engineered transactions to maintain customer lists and make these lists available to the IRS. Nevertheless, the Committee believes that additional legislation is needed to provide the Treasury Department with additional tools to assist its efforts to curtail abusive transactions. Moreover, the Committee believes that a penalty for failing to make the required disclosures, when the imposition of such penalty is not dependent on the tax treatment of the underlying transaction ultimately being sustained, will provide an additional incentive for taxpayers to satisfy their reporting obligations under the new disclosure provisions.

House Report 108-548(I), 108th Cong., 2nd Sess. 2004, at 261 (June 16, 2004) (House Report).

In Footnote 232 of the House Report, the Committee on Ways and Means notes that the statutory definitions of “reportable transaction” and “listed transaction” were intended to incorporate the pre-AJCA regulatory definitions while providing the Secretary with leeway to make changes to those definitions:

The provision states that, except as provided in regulations, a listed transaction means a reportable transaction, which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011. For this purpose, it is expected that the definition of “substantially similar” will be the definition used in Treas. Reg. sec. 1.6011-4(c)(4). However, the Secretary may modify this definition (as well as the definitions of “listed transaction” and “reportable transactions”) as appropriate.

Id. at 261 n.232.

Section 6707A(c)(1) defines a “reportable transaction” as “any transaction with respect to which information is required to be included with a return or statement because, as determined under regulations prescribed under section 6011, such transaction is of a type which the Secretary determines as having a potential for tax avoidance or evasion.” A “listed transaction” is defined by section 6707A(c)(2) as “a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011.”

Section 6111(a), as revised by the AJCA, provides that each material advisor with respect to any reportable transaction must make a return setting forth (1) information identifying and describing the transaction, (2) information describing any potential tax benefits expected to result from the transaction, and (3) such other information as the Secretary may prescribe. Such return must be filed not later than the date specified by the Secretary. Section 6111(b)(2) provides that a reportable transaction has the meaning given to such term by section 6707A(c).

Section 6112(a), as revised by the AJCA, provides that each material advisor with respect to any reportable transaction (as defined in section 6707A(c)) must (whether or not required to file a return under section 6111 with respect to such transaction) maintain a list (1) identifying each person with respect to whom such advisor acted as a material advisor, and (2) containing such other information as the Secretary may by regulations require.

On November 2, 2006, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-103038-05) in the **Federal Register** (71 FR 64488) under section 6011 (November 2006 Transaction of Interest (TOI) Regulations) proposing to add a new category of reportable transaction requiring disclosure under section 6011. The preamble to the November 2006 TOI Regulations (71 FR 64488) explains that these transactions, referred to as transactions of interest, are transactions that the Treasury Department and the IRS believe have the potential for tax avoidance or evasion, but for which the Treasury Department and the IRS lack enough information to determine whether the transaction should be identified as a listed transaction. The November 2006 TOI Regulations proposed that transactions of interest would be identified by the IRS via notice, regulation, or other form of published guidance.

On the same date that the November 2006 TOI Regulations were published, the Treasury Department and the IRS also published two separate notices of proposed rulemaking (REG-103039-05, REG-103043-05) in the **Federal Register** (71 FR 64496, 71 FR 64501) under sections 6111 and 6112, respectively (November 2006 Regulations). The November 2006 Regulations proposed to modify the then-existing regulations relating to the disclosure of reportable transactions by material advisors under section 6111, and the list maintenance requirements of material advisors with respect to reportable transactions under section 6112, in part, to account for the changes made by the AJCA and, in part, to make corresponding updates to the material advisor rules to account for the treatment of transactions of interest as reportable transactions as proposed by the November 2006 TOI Regulations.

After providing notice and opportunity for public comment and considering the comments received, on August 3, 2007, the Treasury Department and the IRS published the November 2006 Regulations and the November 2006 TOI Regulations as final regulations (TD 9350, TD 9351, and TD 9352) in the **Federal Register** (72 FR 43146, 72 FR 43157, and 72 FR 43154) under sections 6011, 6111, and 6112.

II. Disclosure of Reportable Transactions by Participants and Penalties for Failure To Disclose

Section 1.6011-4(a) provides that every taxpayer that has participated in a reportable transaction within the meaning of § 1.6011-4(b) and who is required to file a tax return must file a disclosure statement within the time prescribed in § 1.6011-4(e).

Sections 1.6011-4(d) and (e) provide that the disclosure statement—Form 8886, *Reportable Transaction Disclosure Statement* (or successor form)—must be attached to the taxpayer's tax return for each taxable year for which a taxpayer participates in a reportable transaction. A copy of the disclosure statement must be sent to IRS's Office of Tax Shelter Analysis (OTSA) at the same time that any disclosure statement is first filed by the taxpayer pertaining to a particular reportable transaction.

Reportable transactions include listed transactions, confidential transactions, transactions with contractual protection, loss transactions, and transactions of interest. *See* § 1.6011-4(b)(2) through (6). Consistent with the definitions previously provided in the 2000 Temporary Regulations and later in the 2003 Final Regulations, as promulgated in 2007, § 1.6011-4(b)(2) continues to define a “listed transaction” as a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed

transaction. Section 1.6011-4(b)(6) defines a "transaction of interest" as a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest.

Section 1.6011-4(c)(4) provides that a transaction is "substantially similar" if it is expected to obtain the same or similar types of tax consequences and is either factually similar or based on the same or similar tax strategy. Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. Further, the term substantially similar must be broadly construed in favor of disclosure. For example, a transaction may be substantially similar to a listed transaction or a transaction of interest even though it may involve different entities or use different Code provisions.

Section 1.6011-4(c)(3)(i)(A) provides that a taxpayer has participated in a listed transaction if the taxpayer's tax return reflects tax consequences or a tax strategy described in the published guidance that lists the transaction under §1.6011-4(b)(2). Published guidance also may identify other types or classes of persons that will be treated as participants in a listed transaction. Published guidance may identify types or classes of persons that will not be treated as participants in a listed transaction. Section 1.6011-4(c)(3)(i)(E) provides that a taxpayer has participated in a transaction of interest if the taxpayer is one of the types or classes of persons identified as participants in the transaction in the published guidance describing the transaction of interest.

Section 1.6011-4(e)(2)(i) provides that if a transaction becomes a listed transaction or a transaction of interest after the filing of a taxpayer's tax return reflecting the taxpayer's participation in the transaction and before the end of the period of limitations for assessment for any taxable year in which the taxpayer participated in the transaction, then a disclosure statement must be filed with OTSA within 90 calendar days after the date on which the transaction becomes a listed transaction or transaction of interest. This requirement extends to an amended return and exists regardless of whether the taxpayer participated in the transaction in the year the transaction became a listed transaction or transaction of interest. The Commissioner of Internal Revenue may also determine the time for disclosure of listed transactions and transactions of interest in the published guidance identifying the transaction.

Participants required to disclose these transactions under § 1.6011-4 who fail to do so are subject to penalties under section 6707A. Section 6707A(b) provides that the amount of the penalty is 75 percent of the decrease in tax shown on the return as a result of the reportable transaction (or which would have resulted from such transaction if such transaction were respected for Federal tax purposes), subject to minimum and maximum penalty amounts. The minimum penalty amount is $5,000 in the case of a natural person and $10,000 in any other case. For listed transactions, the maximum penalty amount is $100,000 in the case of a natural person and $200,000 in any other case. For other reportable transactions, including transactions of interest, the maximum penalty is $10,000 in the case of a natural person and $50,000 in any other case.

Additional penalties may also apply. In general, section 6662A imposes a 20 percent accuracy-related penalty on any understatement (as defined in section 6662A(b)(1)) attributable to an adequately disclosed reportable transaction. If the taxpayer had a requirement to disclose participation in the reportable transaction but did not adequately disclose the transaction in accordance with the regulations under section 6011, the taxpayer is subject to an increased penalty rate equal to 30 percent of the understatement. *See* section 6662A(c). Section 6662A(b)(2) provides that section 6662A applies to any item which is attributable to any listed transaction and any reportable transaction (other than a listed transaction) if a significant purpose of such transaction is the avoidance or evasion of Federal income tax.

Participants required to disclose listed transactions who fail to do so are also subject to an extended period of limitations under section 6501(c)(10). That section provides that the time for assessment of any tax with respect to the transaction shall not expire before the date that is one year after the earlier of the date the participant discloses the transaction or the date a material advisor discloses the participation pursuant to a written request under section 6112(b)(1)(A).

III. Disclosure of Reportable Transactions by Material Advisors and Penalties for Failure To Disclose

Section 301.6111-3(a) of the Procedure and Administration Regulations provides that each material advisor with respect to any reportable transaction, as defined in § 1.6011-4(b), must file a return as described in § 301.6111-3(d) by the date described in § 301.6111-3(e).

Section 301.6111-3(b)(1) provides that a person is a material advisor with respect to a transaction if the person provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and directly or indirectly derives gross income in excess of the threshold amount as defined in § 301.6111-3(b)(3) for the material aid, assistance, or advice. Under § 301.6111-3(b)(2)(i) and (ii), a person provides material aid, assistance, or advice if the person provides a tax statement, which is any statement (including another person's statement), oral or written, that relates to a tax aspect of a transaction that causes the transaction to be a reportable transaction as defined in § 1.6011-4(b)(2) through (7).

Material advisors must disclose transactions on Form 8918, *Material Advisor Disclosure Statement* (or successor form), as provided in § 301.6111-3(d) and (e). Section 301.6111-3(e) provides that the material advisor's disclosure statement for a reportable transaction must be filed with OTSA by the last day of the month that follows the end of the calendar quarter in which the advisor becomes a material advisor with respect to a reportable transaction or in which the circumstances necessitating an amended disclosure statement occur. A person may become a material advisor with respect to transactions that are later identified as listed transactions or transactions of interest. See § 301.6111-3(b)(4). The disclosure statement must be sent to OTSA at the address provided in the Instructions for Form 8918 (or successor form).

Section 301.6111-3(d)(2) provides that the IRS will issue to a material advisor a reportable transaction number with respect to the disclosed reportable transaction. Receipt of a reportable transaction number does not indicate that the disclosure statement is complete, nor does it indicate that the transaction has been reviewed, examined, or approved by the IRS. Material advisors must provide the reportable transaction number to all taxpayers and material advisors for whom the material advisor acts as a material advisor as defined in § 301.6111-3(b). The reportable transaction number must be provided at the time the transaction is entered into, or, if the transaction is entered into prior to the material advisor receiving the reportable transaction number, within 60 calendar days from the date the reportable transaction number is mailed to the material advisor. Additionally, material advisors must prepare and maintain lists identifying each person with respect to whom the advisor acted as a material advisor with respect to the reportable transaction in accordance with § 301.6112-1(b) and furnish such lists to the IRS in accordance with § 301.6112-1(e).

Section 6707(a) provides that a material advisor who fails to file a timely disclosure, or files an incomplete or false disclosure statement, is subject to a penalty. Pursuant to section 6707(b)(2), for listed transactions, the penalty is the greater of (A) $200,000, or (B) 50 percent of the gross income derived by such person with respect to aid, assistance, or advice which is provided with respect to the listed transaction before the date the return is filed under section 6111. Pursuant to section 6707(b)(1), the penalty for other reportable transactions, including transactions of interest, is $50,000.

A material advisor may also be subject to a penalty under section 6708 for failing to maintain a list under section 6112(a) and failing to make the list available upon written request to the Secretary in accordance with section 6112(b) within 20 business days after the date of such request. Section 6708(a) provides that the penalty is $10,000 per day for each day of the failure after the 20th day. However, no penalty will be imposed with respect to the failure on any day if such failure is due to reasonable cause.

IV. Micro-Captive Transactions and Notice 2016-66

As enacted by section 1024 of the Tax Reform Act of 1986, Public Law 99-514, 100 Stat. 2085, 2405 (October 22, 1986), section 831(a) generally imposes tax on the taxable income (determined under the special rules for calculating taxable income of insurance companies in part II of subchapter L of chapter 1 of the Code) of every insurance company other than a life insurance company (nonlife insurance company), for each taxable year computed as provided in section 11 of the Code. However, certain small nonlife insurance companies may elect to be subject to the alternative tax imposed by section 831(b).

Upon election by an eligible nonlife insurance company (eligible electing company) to be taxed under section 831(b), in lieu of the tax otherwise imposed by section 831(a), section 831(b) imposes tax on the company's income computed by multiplying the taxable investment income of the eligible electing company (determined under section 834 of the Code) for the taxable year by the rates provided in section 11(b) of the Code. Premium income of a nonlife insurance company is included in taxable income under section 831(a), but not taxable investment income under section 834. Thus, an eligible electing company pays no tax on premium income for taxable years for which its election is in effect.

Congress enacted section 333 of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), div. Q. of Public Law 114-113, 129 Stat. 2242, 3040 (December 18, 2015), to both tighten and expand the requirements for qualifying under section 831(b), effective for taxable years beginning after December 31, 2016. As amended by the PATH Act, section 831(b) requires an eligible electing company to be an insurance company (within the meaning of section 816(a) of the Code) having net written premiums or, if greater, direct written premiums, for the taxable year not exceeding $2.2 million as adjusted for inflation (net written premium limitation) and to meet the diversification requirements of section 831(b)(2)(B). The last sentence of section 831(b)(2)(A) provides that an election under section 831(b) applies to the taxable year for which it is made and all subsequent taxable years for which the net written premium limitation and the diversification requirements are met and may be revoked only with the Secretary's consent. In addition, section 831(d) requires every eligible electing company that has a section 831(b) election in effect to furnish to the Secretary “at such time and in such manner as the Secretary shall prescribe such information for such taxable year as the Secretary may require with respect to” the diversification requirements of section 831(b)(2)(B).

On November 21, 2016, the Treasury Department and the IRS published Notice 2016-66, 2016-47 I.R.B 745, which identified certain micro-captive transactions as transactions of interest. On January 17, 2017, the IRS published Notice 2017-08, 2017-3 I.R.B. 423, which modified Notice 2016-66 by providing for an extension of time for participants and material advisors to file their disclosures.

Notice 2016-66 alerted taxpayers and their representatives pursuant to § 1.6011-4(b)(6) and for purposes of § 1.6011-4(b)(6) and sections 6111 and 6112, that the Treasury Department and the IRS identified as transactions of interest certain micro-captive transactions in which a taxpayer attempts to reduce the aggregate taxable income of the taxpayer, related persons, or both, using contracts that the parties treat as insurance contracts and a related company that the parties treat as an insurance company. Notice 2016-66 also alerted persons involved with the identified transactions that certain responsibilities may arise from their involvement.

Notice 2016-66 describes the following micro-captive transaction as a transaction of interest: (1) a company that the parties treat as an insurance company (Captive) elects to exclude premiums from taxable income under section 831(b); (2) at least 20 percent of the voting power or value of the outstanding stock of Captive is directly or indirectly owned by the insured entity (Insured), owners of Insured, or persons related to Insured or its owners (20-percent relationship factor); and (3) either or both of the following apply: (i) Captive has at any time during a defined Computation Period (referred to as the Notice Computation Period) directly or indirectly made available as financing, or otherwise conveyed or agreed to make available or convey, to certain related persons in a transaction that did not result in taxable income or gain to the recipient any portion of the payments treated as premiums, such as through a guarantee, a loan, or other transfer of Captive's capital (financing factor), or (ii) the amount of liabilities incurred by Captive for insured losses and claim administration expenses during the Notice Computation Period is less than 70 percent of the amount equal to premiums earned by Captive during that period less policyholder dividends paid by Captive during that period (70-percent loss ratio factor).

Notice 2016-66 defines the Notice Computation Period as the most recent five taxable years of Captive or, if Captive has been in existence for less than five taxable years, the entire period of Captive's existence. For purposes of the preceding sentence, if Captive has been in existence for less than five taxable years and Captive is a successor to one or more Captives created or availed of in connection with a transaction described in the notice, taxable years of such predecessor entities are treated as taxable years of Captive. A short taxable year is treated as a taxable year.

Notice 2016-66 also provides that the arrangement is not treated as a transaction of interest if the microcaptive arrangement provides insurance for employee compensation or benefits and the arrangement is one for which the Employee Benefits Security Administration of the U.S. Department of Labor has issued a Prohibited Transaction Exemption. A Prohibited Transaction Exemption may be granted by the U.S. Department of Labor on an individual basis or may fall under the class exemption for captives. The Prohibited Transaction Exemption procedures are published as final regulations in the **Federal Register** (76 FR 66637). The Department of Labor's proposed amendments to the Prohibited Transaction Exemption procedures were published on March 15, 2022, in the **Federal Register** (87 FR 14722).

Notice 2016-66 requires disclosure of the information specified in § 1.6011-4(d) and the Instructions to Form 8886 (or successor form), which includes identifying and describing the transaction in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction and identity of all parties involved in the transaction. Notice 2016-66 provides that for all participants, describing the transaction in sufficient detail includes, but is not limited to, describing on Form 8886 (or successor form) when and how the taxpayer became aware of the transaction. The notice further provides that for Captive, describing the transaction in sufficient detail includes, but is not limited to, describing the following on Form 8886 (or successor form): (1) whether Captive is reporting because (i) the 70-percent loss ratio factor is met for the taxable year; (ii) the financing factor is met for the taxable year; or (iii) both (i) and (ii); (2) under what authority Captive is chartered; (3) all the type(s) of coverage provided by Captive during the year or years of participation (if disclosure pertains to multiple years); (4) how the amounts treated as premiums for coverage provided by Captive during the year or years of participation (if disclosure pertains to multiple years) were determined, including the name and contact information of any actuary or underwriter who assisted in these determinations; (5) any claims paid by Captive during the year or years of participation (if disclosure pertains to multiple years), and the amount of, and reason for, any reserves reported by Captive on the annual statement; and (6) the assets held by Captive during the year or years of participation (if disclosure pertains to multiple years).

V. Comments Submitted in Response to Notice 2016-66

Comments submitted in response to Notice 2016-66 were carefully considered in the development of these proposed regulations. Although the Administrative Procedure Act (APA), 5 U.S.C. 551–559, does not require a response to those comments, the comments are described here in an effort to assist taxpayers in understanding the provisions of the proposed regulations described in the Explanation of Provisions section.

First, some commenters suggested that changes to the Form 1120—PC, *U.S. Property and Casualty Insurance Company Income Tax Return,* would be better suited to capture the information sought by Notice 2016-66. Other commenters indicated that the information sought could be readily obtained from the existing Forms 1120—PC being filed, so any additional reporting would be unnecessarily duplicative and burdensome. However, changes to the Form 1120—PC would at a minimum impact all nonlife insurance companies that make section 831(b) elections, not only participants in the micro-captive transactions described in the proposed regulations. Also, some of the requested information is not readily available from filed Forms 1120—PC, such as the descriptions of the types of coverages provided by a Captive and the name and contact information of any actuary or underwriter who assisted Captive in the determination of amounts treated as premiums. Additionally, limiting the collection of information to only those entities filing the Form 1120—PC would be insufficient to gather relevant information, as information regarding Insureds and promoters of the transactions would not be included.

Second, commenters also suggested that the reporting requirements under Notice 2016-66 are contrary to Congressional intent in enacting section 333 of the PATH Act, which, as noted earlier, effective for taxable years beginning after December 31, 2016, modified the section 831(b) eligibility rules for a property and casualty insurance company to elect to be taxed only on taxable investment income. The provision increased the limit on net written premiums (or, if greater, direct written premiums) from $1,200,000 to $2,200,000 and indexed that amount for inflation. The provision also added diversification requirements to the eligibility rules. However, nothing in the statutory language or legislative history of the PATH Act suggests that Congress intended to provide the benefits of section 831(b) to companies that do not qualify as insurance companies for Federal income tax purposes. As exemplified by the transactions described in *Avrahami* v. *Commissioner, 149 T.C. 144* (2017), *Syzygy Insurance Co., Inc.* v. *Commissioner,* T.C. Memo. 2019-34, and *Caylor Land 8e Development, Inc.* v. *Commissioner,* T.C. Memo. 2021-30, some companies claiming the benefits of section 831(b) do not meet these basic eligibility requirements for such treatment. *See also Reserve Mechanical Corp.* v. *Commissioner,* 34 F.4th 881 (10th Cir. 2022) (concluding company filing as a tax-exempt entity under section 501(c)(15) did not qualify as an insurance company for Federal income tax purposes using similar analysis). The proposed regulations, like Notice 2016-66, would apply to entities that claim the benefits of section 831(b) when certain factors indicate that they do not or may not qualify as insurance companies for Federal income tax purposes.

Third, other commenters indicated that the reporting requirements were unduly burdensome, as well as duplicative, because the information sought could be readily obtained from a smaller subgroup of the participants in a transaction. However, the reporting and recordkeeping required for reportable transactions from each participant ensure that the Service can identify all of the participants of a particular transaction and that all participants are aware of their participation in a reportable transaction. Nevertheless, the proposed regulations significantly narrow the information sought from participants compared to that required by Notice 2016-66 and provide a disclosure safe harbor to a significant number of participants, thereby reducing the burden in reporting to the maximum extent consistent with sound tax administration. *See* proposed § 1.6011-10(e)(2) and (f) and proposed § 1.6011-11(e)(2) and (f).

Fourth, additional commenters on Notice 2016-66 expressed concerns regarding certain arrangements in which a service provider, automobile dealer, lender, or retailer (Seller) sells insurance contracts to its customers in connection with the products or services being sold (Consumer Coverage). These commenters

recommended that such Consumer Coverage arrangements be excepted from the disclosure requirements. The proposed regulations provide a limited exception for certain participants in Consumer Coverage arrangements. *See* proposed §§1.6011-10(d)(2) and 1.6011-11(d)(2).

Finally, commenters argued that the 20-percent relationship factor and the 70-percent loss ratio factor described in sections 2.01(d) and 2.01(e)(2) of Notice 2016-66, respectively, are overly broad and arbitrary. However, the Treasury Department and the IRS have determined that the factors are objective and reasonably determined based on existing statutory provisions and available industry data. The 20-percent relationship factor was based on the diversification requirements established by section 333 of the PATH Act. While one part of the PATH Act diversification requirements is based on the percentage of premiums from related insureds, requiring that no more than 20 percent of net written premiums (or if greater, direct written premiums) for a taxable year is attributable to any one policyholder, the 20-percent threshold in Notice 2016-66 is based on concentration of ownership of stock in a Captive when Insured or Insured's owner owns Captive's stock or is related to Captive's owner. Both requirements are based on a lack of diversification and identify a threshold at which a lack of diversification may facilitate abuse.

Similarly, the 70-percent loss ratio factor was informed by, but is less burdensome than, the 85 percent medical loss ratio test enacted by Congress in section 833(c)(5) of the Code for Blue Cross and Blue Shield organizations and other health insurers that are entitled to certain tax benefits that are not available to other nonlife insurance companies, as well as the medical loss ratio computed under section 2718(b) of the Public Health Service Act, 42 U.S.C. 300gg-18. The loss ratio factor in Notice 2016-66 compares claims and expenses to premiums charged in a manner similar to the medical loss ratio test in section 833(c)(5) of the Code and the medical loss ratio computed under section 2718(b) of the Public Health Service Act. However, the medical loss ratio has a narrower focus than the Notice 2016-66 loss ratio factor and is computed as a percentage of the total premium revenue (excluding Federal and State taxes and licensing or regulatory fees) an issuer expends (1) on reimbursement for clinical services provided to enrollees under such coverage and (2) for activities that improve health care quality of enrollees.

The Treasury Department and IRS also considered data from the National Association of Insurance Commissioners (NAIC) in determining the applicable loss ratio factor. NAIC, in its 2021 Annual Property & Casualty and Title Insurance Industries Report (2021 NAIC P&C Report), indicated that annual loss ratios for property and casualty companies averaged 72.5 percent for that year. *See Insurance Industry Snapshots and Analysis Reports* ((July 21, 2022), *https://content.naic.org/cipr_topics/topic_insurance_industry_snapshots_and_analysis_reports.htm* (last visited April 3, 2023). The 2021 NAIC P&C Report is “produced from insurer statutory filings and represent[s] approximately 99% of all insurers expected to file the NAIC Financial Data Repository.” *Id.* The single-year average loss ratio for property and casualty companies ranged between 67.2 and 76.2 percent per year from 2012 to 2021. *See U.S. Property & Casualty and Title Insurance Industries-2021 Full Year Results* (2022), *https://content.naic.org/sites/default/files/inline-files/2021%20Annual%20Property%20%26%20Casualty%20and%20Title%20Insurance%20Industry%20Report.pdf* (last visited April 3, 2023).

Commenters indicated that some Captives electing the alternative tax under section 831(b) have loss ratios that fall below the industry-wide average during a given year of operation and suggested that the loss ratio in Notice 2016-66 is set too high. However, the average loss ratio reported by the NAIC and the loss ratio factor in Notice 2016-66 are computed differently and are not directly comparable. First, the average loss ratio reported by the NAIC reflects the ratio of net losses incurred and loss expenses incurred to net premiums earned, without adjustment for policyholder dividends paid, whereas Captive's loss ratio factor under Notice 2016-66 subtracts policyholder dividends paid from premiums earned by Captive. This means that, for an

entity that pays policyholder dividends, the loss ratio factor under Notice 2016-66 would be higher than its NAIC loss ratio. Second, the loss ratio factor in Notice 2016-66 reflects the ratio of insured losses and claims administration expenses during the Notice Computation Period, which may be as long as five years. By contrast, the average loss ratio reported by the NAIC is a single-year average. Accordingly, even Captives electing the alternative tax under section 831(b) that have loss ratios that fall below the industry-wide average for property and casualty companies in any particular year may not have loss ratio factors that cause a transaction to be described in Notice 2016-66 or the proposed regulations. The Treasury Department and the IRS therefore view the average loss ratio data reported by the NAIC as supportive of the loss ratio factors provided in Notice 2016-66 and in these proposed regulations. *See* proposed §§1.6011-10(c)(2) and 1.6011-11(c).

Despite commenters' objections to the 20-percent relationship factor and 70-percent loss ratio factor, the commenters did not identify different factors or industry-wide standards for small insurers that would distinguish abusive from non-abusive transactions or provide examples of non-abusive transactions for which disclosure was required as a result of these factors.

These objective factors in Notice 2016-66 have been effective in identifying transactions for which disclosure should be required and are reasonable given existing statutory provisions and available industry data.

To better ensure non-abusive transactions are not required to be reported under the proposed regulations, however, the proposed regulations lower the loss ratio factor for both the micro-captive transactions identified in proposed § 1.6011-10(a) as listed transactions (Micro-captive Listed Transactions) and the micro-captive transactions identified in proposed § 1.6011-11(a) as transactions of interest (Micro-captive Transactions of Interest) from 70 percent to 65 percent. *See* proposed §§1.6011-10(c)(2) and 1.6011-11(c). Additionally, the computation period used to determine the loss ratio factor is extended from a Notice Computation Period of up to five taxable years to a computation period of up to nine taxable years (referred to as the Transaction of Interest Computation Period) for the Micro-captive Transaction of Interest. *See* proposed § 1.6011-11(b)(2). For the Micro-captive Listed Transaction, the computation period used to determine the loss ratio factor (referred to as the Loss Ratio Factor Computation Period) is ten taxable years. *See* proposed § 1.6011-10(b)(2)(ii).

For the foregoing reasons, the IRS intends to challenge the purported tax benefits from transactions identified in proposed § 1.6011-10(c) as listed transactions, and the IRS may challenge the purported tax benefits from transactions identified in proposed § 1.6011-11(c) as transactions of interest. The IRS may also challenge the purported tax benefits from these transactions based on the economic substance, business purpose, or other rules or doctrines if applicable based on the facts of a particular case.

VI. Purpose of Proposed Regulation

On March 3, 2022, the Sixth Circuit issued an order in *Mann Construction* v. *United States,* 27 F.4th 1138, 1147 (6th Cir. 2022), holding that Notice 2007-83, 2007-2 C.B. 960, which identified certain trust arrangements claiming to be welfare benefit funds and involving cash value life insurance policies as listed transactions, violated the APA, because the notice was issued without following the notice-and-comment procedures required by section 553 of the APA. The Sixth Circuit concluded that Congress did not clearly express an intent to override the notice-and-comment procedures required by section 553 of the APA when it enacted the AJCA. *27 F.4th at 1148*. The Sixth Circuit reversed the decision of the district court, which held that Congress had authorized the IRS to identify listed transactions without notice and comment. *See Mann Construction, Inc.* v. *United States,* 539 F.Supp.3d 745, 763 (E.D. Mich. 2021).

In *CIC Services, LLC* v. *IRS,* the United States District Court for the Eastern District of Tennessee, which is located in the Sixth Circuit, viewed the analysis in *Mann Construction* as controlling and vacated Notice 2016-66, holding that the IRS failed to comply with the APA's notice-and-comment procedures. The Court also held that the IRS acted arbitrarily and capriciously based on the administrative record. *CIC Services, LLC* v. *IRS,* 2022 WL 985619 (E.D. Tenn. March 21, 2022), *as modified by* 2022 WL 2078036 (E.D. Tenn. June 2, 2022); *see also Green Valley Investors, LLC, et al.* v. *Commissioner,* 159 T.C. No. 5 (Nov. 9, 2022) (relying on *Mann Construction* in holding that Notice 2017-10, 2017-4 I.R.B. 544 (identifying certain syndicated conservation easements as listed transactions) was improperly issued because it was issued without following the APA's notice-and-comment procedures); *Green Rock, LLC* v. *IRS,* No. 2:21-cv-01320-ACA, 2023 U.S. Dist. LEXIS 17670 (N.D. Ala. Feb. 2, 2023) (holding that notice and comment procedures were required before issuance of Notice 2017-10).

In light of the decision by the district court in *CIC Services,* the IRS will not enforce the disclosure requirements or penalties that are dependent upon the procedural validity of Notice 2016-66. Thus, the Treasury Department and the IRS are issuing these proposed regulations to identify certain microcaptive transactions as Micro-captive Transactions of Interest. In addition, this document obsoletes Notice 2016-66 (as modified by Notice 2017-08). The obsoletion of the notice, however, has no effect on the merits of the tax benefits claimed from the transactions themselves and related litigation, or income tax examinations and promoter investigations relating to micro-captive transactions.

The Treasury Department and the IRS disagree with the Sixth Circuit's decision in *Mann Construction* and the Tax Court's decision in *Green Valley* and are continuing to defend the validity of notices identifying transactions as listed transactions in circuits other than the Sixth Circuit. However, to help allow for consistent enforcement throughout the nation, the Treasury Department and the IRS are proposing to identify certain other micro-captive transactions as Microcaptive Listed Transactions by regulation.

Explanation of Provisions

A. Micro-Captive Listed Transactions and Micro-Captive Transactions of Interest

This section generally describes the micro-captive transactions that are the focus of the proposed regulations and why the Micro-captive Listed Transactions are abusive and the Microcaptive Transactions of Interest have the potential for abuse. This section also describes the proposed regulations identifying Micro-captive Listed Transactions and Micro-captive Transactions of Interest.

1. In General

The Treasury Department and the IRS are aware of a micro-captive transaction, in which a taxpayer attempts to reduce the aggregate taxable income of the taxpayer, persons related to the taxpayer, or both, using contracts that the parties treat as insurance contracts and a related Captive. In some cases, Captive enters into a contract with a related entity that the parties treat as an insurance contract. In other cases, Captive and a related entity enter into separate contracts with one or more unrelated intermediaries. For example, the related entity and an intermediary may enter into a contract that the parties treat as an insurance contract, and Captive may then enter into a separate contract with the intermediary that the parties treat as a reinsurance contract covering the “risks” under the contract between the related entity and the intermediary. Each entity that makes payments to an intermediary or Captive under these contracts treats the payments as insurance premiums that are within the scope of § 1.162-1(a) and deducts the payments as ordinary and necessary business expenses under section 162. Captive treats the payments received from the related entity

or intermediary under a contract treated as an insurance contract or reinsurance contract as premiums for insurance coverage.

Captive asserts that it is taxable as a nonlife insurance company under the Code and, if it is not a domestic corporation, makes an election under section 953(d) of the Code to be treated as a domestic corporation for purposes of the Code. Captive makes an election under section 831(b) to be taxed only on taxable investment income (defined in section 834). Captive accordingly excludes from the computation of its taxable income the payments received from the related entity or intermediary treated as premiums. For each taxable year in which the micro-captive transaction is in effect, the transaction is structured so that Captive does not have net premiums written (or, if greater, direct premiums written) that exceed the statutory limit. For taxable years beginning after December 31, 2016, the statutory limit is $2,200,000, adjusted annually for inflation ($2,650,000 for taxable years beginning in 2023).

Since the publication of Notice 2016-66, examinations of taxpayers and promoters and information received through disclosures filed in response to Notice 2016-66 have clarified the Treasury Department's and the IRS's understanding of micro-captive transactions, including the scope of participation. Further, in the three section 831(b) micro-captive cases decided on their merits since the publication of Notice 2016-66, the U.S. Tax Court held that the micro-captive transactions at issue did not meet the requirements for treatment as insurance for Federal income tax purposes. *See Avrahami* v. *Commissioner, 149 T.C. at 144*; *Syzygy* v. *Commissioner,* T.C. Memo. 2019-34; and *Caylor* v. *Commissioner,* T.C. Memo. 2021-30; *see also Reserve Mechanical Corp.* v. *Commissioner, 34 F.4th at 881* (concluding transactions entered into by company filing as a tax-exempt entity under section 501(c)(15) did not meet the requirements for treatment as insurance for Federal income tax purposes using similar analysis). Taking into account only the years in issue in these decisions, the information included in the Court's opinions indicates that the transactions at issue had the elements that would require disclosure under Notice 2016-66. Accordingly, the Treasury Department and the IRS have determined that certain micro-captive transactions are abusive tax avoidance transactions and certain other micro-captive transactions have the potential for tax avoidance or evasion.

As further discussed in sections B.1. through B.3. of this Explanation of Provisions, the Treasury Department and the IRS have determined that two categories of micro-captive transactions, described in proposed § 1.6011-10(c)(1) and (c)(2), are tax avoidance transactions, and thus propose to identify such transactions as listed transactions. The transactions in both categories involve related parties, including a Captive, at least 20 percent of the voting power or the value of the outstanding stock or equity interest of which is owned, directly or indirectly, by an Insured, an Owner, or persons Related to an Insured or an Owner. *See* proposed § 1.6011-10(b)(1)(iii). The first category of these transactions is identified by the presence of a financing factor, described in proposed § 1.6011-10(c)(1). The second category of these transactions is identified by a loss ratio factor that falls below 65 percent based on a Loss Ratio Computation Period of ten taxable years, as described in proposed § 1.6011-10(c)(2). The proposed regulations therefore identify transactions that are the same as, or substantially similar to, the Microcaptive Listed Transaction described in proposed § 1.6011-10(a) as listed transactions for purposes of § 1.6011-4. As noted previously, a transaction is "substantially similar" if it is expected to obtain the same or similar types of tax consequences and is either factually similar or based on the same or similar tax strategy, even though it may involve different entities or use different Code provisions.

As further discussed in section B.1. and B.3. of this Explanation of Provisions, the Treasury Department and the IRS have also determined that a third category of micro-captive transactions, described in proposed § 1.6011-11(c), has a potential for tax avoidance or evasion, and thus propose to identify such transactions as transactions of interest. This category of micro-captive transactions also involves related parties as described in proposed § 1.6011-10(b)(1)(iii) and is identified by the presence of a loss ratio factor that falls below 65

percent over a shorter Transaction of Interest Computation Period, generally because Captives involved have been in operation for a shorter period of time. With respect to this third category of transactions, the Treasury Department and the IRS require more information to determine if the transactions are being used for tax avoidance or evasion. The proposed regulations therefore identify transactions that are the same as, or substantially similar to, the Microcaptive Transaction of Interest described in proposed § 1.6011-11(a) as transactions of interest for purposes of §1.6011-4(b)(6).

2. Abuses

In Micro-captive Listed Transactions and Micro-captive Transactions of Interest, related parties claim the Federal income tax benefits of treating the contracts as insurance (or reinsurance) contracts. Insured deducts premiums paid to Captive under section 162, while the related Captive excludes the premium income from its taxable income by electing under section 831(b) to be taxed only on its taxable investment income.

Neither the Code nor the regulations thereunder define the terms "insurance" or "insurance contract." The Supreme Court has explained that for an arrangement to constitute insurance for federal income tax purposes, both risk shifting and risk distribution must be present. *Helvering* v. *Le Gierse,* 312 U.S. 531 (1941). The risk transferred must be risk of economic loss. *Allied Fidelity Corp.* v. *Commissioner,* 572 F.2d 1190, 1193 (7th Cir. 1978). The risk must contemplate the fortuitous occurrence of a stated contingency, *Commissioner* v. *Treganowen, 183 F.2d 288*, 290–91 (2d Cir. 1950), and must not be merely an investment or business risk. Rev. Rul. 2007-17, 2007-2 C.B. 127. In addition, the arrangement must constitute insurance in the commonly accepted sense. *See, e.g., Rent-A-Center, Inc.* v. *Commissioner, 142 T.C. 1*, 10–13 (2014).

In many micro-captive transactions, however, the manner in which the contracts are interpreted, administered, and applied is inconsistent with arm's length transactions and sound business practices. Captive typically does not behave as an insurance company commonly would, indicating that Captive is not issuing insurance contracts and the transaction does not constitute insurance for Federal income tax purposes. For example, Captive may fail to adequately distribute risk or fail to employ actuarial techniques to establish premium rates that appropriately reflect the risk of loss and costs of conducting an insurance business. Captive may also use its premium income for purposes other than administering and paying claims under the contract(s), including routing funds that have not been taxed to the Insured or a person related to the Insured or its owners. A micro-captive transaction may share other characteristics with the purported insurance transactions considered by the Tax Court in *Avrahami, Syzygy,* and *Caylor,* or with the transactions considered in other cases in which the courts determined the transactions were not insurance for Federal income tax purposes. *See, e.g., Reserve Mechanical Corp.* v. *Commissioner, 34 F.4th 881* (10th Cir. 2022). The net effect of participating in this transaction is that the Insured claims a tax deduction for transferring amounts treated as premiums to Captive, which is owned by parties related to Insured, and Captive is not taxed on the corresponding income.

If the transaction does not constitute insurance, Insured is not entitled to deduct under section 162 as a trade or business expense the amount treated as an insurance premium. In addition, if Captive does not actually provide insurance, it does not qualify as an insurance company and its elections to be taxed only on its taxable investment income under section 831(b) and to be treated as a domestic insurance company under section 953(d) are invalid.

These proposed regulations inform taxpayers that participate in transactions described in proposed §§ 1.6011-10(c) and 1.6011-11(c), and substantially similar transactions, and persons who act as material advisors with respect to these transactions, and substantially similar transactions, that they must disclose in

accordance with the rules provided in § 1.6011-4(a) and section 6111(a), respectively. Material advisors must also maintain lists as required by section 6112.

As previously noted, the IRS intends to challenge the claimed tax benefits from Micro-captive Listed Transactions, and may challenge the claimed tax benefits from Micro-captive Transactions of Interest. Examinations of these micro-captive transactions may result in adjustments including full disallowance of claimed micro-captive insurance premium deductions, inclusion in income of amounts received by Captive, imposition of withholding tax liability under section 1461 of the Code for failing to deduct and withhold tax on payments made to a foreign Captive, imposition of a 20 percent or 40 percent penalty for lack of economic substance under section 6662(b)(6) or (i)(1) of the Code, which may not be avoided by a reasonable cause exception, and imposition of other applicable taxes and penalties.

3. Micro-Captive Listed Transactions

Proposed § 1.6011-10(a) provides that transactions that are the same as, or substantially similar to, transactions described in proposed § 1.6011-10(c) are identified as listed transactions for purposes of § 1.6011-4(b)(2), except as provided in proposed § 1.6011-10(d). Proposed § 1.6011-10(b) provides definitions of terms used to describe Micro-captive Listed Transactions, including Captive, Financing Computation Period, Loss Ratio Computation Period, Contract, Insured, Intermediary, Recipient, and Related. In particular, Captive is defined as an entity that elects under section 831(b) to be taxed as an insurance company only on its taxable investment income; issues a Contract to an Insured, reinsures a Contract of an Insured issued by an Intermediary, or both; and has at least 20 percent of its assets or voting power or the value of its outstanding stock or equity interests directly or indirectly, individually or collectively, owned by an Insured, an Owner, or persons Related to an Insured or Owner. The term Related is defined in proposed § 1.6011-10(b)(8) by reference to sections 267(b), 707(b), 2701(b)(2)(C), and 2704(c)(2). The definition incorporates the constructive ownership rules in those sections. Proposed § 1.6011-10(b) also provides the rules for persons that hold derivatives and for the treatment of beneficiaries of trusts and estates. The treatment of beneficiaries of trusts in proposed § 1.6011-10(b) does not affect the application of Subpart E of Subchapter J of Chapter 1 of Subtitle A, which provides rules concerning when a grantor or another person is treated as the owner of a portion of that trust.

A transaction is described in proposed § 1.6011-10(c) if it is described in proposed § 1.6011-10(c)(1), or (c)(2), or both. Proposed § 1.6011-10(c)(1) describes transactions that involve a Captive that, at any time during the Financing Computation Period, directly or indirectly made available as financing or otherwise conveyed or agreed to make available or convey to a Recipient, in a transaction that did not result in taxable income or gain to the Recipient, any portion of the payments under the Contract, such as through a guarantee, a loan, or other transfer of Captive's capital, including such financings or conveyances made prior to the Financing Computation Period that remain outstanding as of the taxable year in which disclosure is required. Any amounts that a Captive made available as financing or otherwise conveyed or agreed to make available or convey to a Recipient are presumed to be portions of the payments under the Contract to the extent such amounts when conveyed or made available are in excess of Captive's cumulative after-tax net investment earnings minus any outstanding financings or conveyances. *See* section B.2. of this Explanation of Provisions. The Financing Computation Period is the most recent five taxable years of Captive, or all taxable years of Captive, if Captive has been in existence for less than five taxable years. For purposes of determining the Financing Computation Period, each short taxable year is a separate taxable year and taxable years of predecessor entities are treated as taxable years of Captive.

Proposed §1.6011-10(c)(2) describes transactions that involve a Captive for which the amount of liabilities incurred for insured losses and claim administration expenses during a Loss Ratio Computation Period is less

than 65 percent of the amount equal to premiums earned by Captive during the Loss Ratio Computation Period less policyholder dividends paid by Captive during the Loss Ratio Computation Period. *See* section B.3. of this Explanation of Provisions. The Loss Ratio Computation Period is the most recent ten taxable years of Captive, each short taxable year is a separate taxable year, and the taxable years of predecessor entities are treated as taxable years of Captive. Proposed § 1.6011-10(c)(2) does not apply to any Captive that has been in existence for less than ten taxable years, including taxable years of predecessor entities.

Proposed § 1.6011-10(d) provides that a transaction described in proposed § 1.6011-10(c) is not classified as a listed transaction if the transaction (1) provides insurance for employee compensation or benefits and is one for which the Employee Benefits Security Administration of the U.S. Department of Labor has issued a Prohibited Transaction Exemption, or (2) is a Consumer Coverage reinsurance arrangement described in proposed § 1.6011-10(d)(2). *See* section B.6. of this Explanation of Provisions.

Proposed § 1.6011-10(e)(1) provides the rules for determining who is a participant in a listed transaction described in proposed § 1.6011-10(a). Proposed § 1.6011-10(e)(2) provides a safe harbor from the disclosure requirements for certain persons. *See* section B.5. of this Explanation of Provisions.

Proposed § 1.6011-10(f) describes information that participants must provide to satisfy the disclosure requirements of § 1.6011-4(d). *See* section B.4. of this Explanation of Provisions.

Proposed § 1.6011-10(g) provides the applicability date for the proposed regulations.

4. Micro-Captive Transactions of Interest

Proposed § 1.6011-11(a) provides that transactions that are the same as, or substantially similar to, transactions described in proposed § 1.6011-11(c) are identified as transactions of interest for purposes of § 1.6011-4(b)(6), except as provided in proposed § 1.6011-11(d). Proposed § 1.6011-11(b) provides definitions of terms used to describe Micro-captive Transactions of Interest by reference to the relevant definitions in proposed § 1.6011-10(b), except for the definition of the computation period. Proposed §1.6011-11(b)(2) defines the Transaction of Interest Computation Period for Micro-captive Transactions of Interest as the most recent nine taxable years, or the entire period of Captive's existence if Captive has been in existence for less than nine taxable years. For this purpose, each short taxable year is a separate taxable year, and the taxable years of predecessor entities are treated as taxable years of Captive.

A transaction is described in proposed § 1.6011-11(c) if it involves the issuance of a Contract to an Insured by a Captive, or the reinsurance by a Captive of a Contract issued to an Insured by an Intermediary, and involves a Captive for which the amount of liabilities incurred for insured losses and claim administration expenses during the Transaction of Interest Computation Period is less than 65 percent of the amount equal to premiums earned by Captive during the Transaction of Interest Computation Period less policyholder dividends paid by Captive during the Transaction of Interest Computation Period. *See* section B.3. of this Explanation of Provisions.

Proposed § 1.6011-11(d) provides that a transaction described in proposed § 1.6011-11(c) is not classified as a “transaction of interest” if the transaction (1) provides insurance for employee compensation or benefits and is one for which the Employee Benefits Security Administration of the U.S. Department of Labor has issued a Prohibited Transaction Exemption, or (2) is a Consumer Coverage reinsurance arrangement described in proposed § 1.6011-11(d)(2). *See* section B.6. of this Explanation of Provisions. Additionally, proposed § 1.6011-11(d)(3) provides that a transaction described in proposed § 1.6011-11(c) is not classified as a “transaction of interest” if the transaction is identified as a “listed transaction” in proposed § 1.6011-10(a).

Under proposed § 1.6011-11(d)(3), a transaction that would (but for that subsection) be identified as both a "listed transaction" under proposed § 1.6011-10 and a "transaction of interest" under proposed § 1.6011-11, is identified as a "listed transaction" only, and participants in the transaction must disclose it as such. Material advisors that are uncertain about whether the transaction they are required to disclose should be reported as a Micro-captive Listed Transaction or as a Micro-captive Transaction of Interest should disclose the transaction as a Micro-captive Listed Transaction, and will not be required to disclose the transaction a second time if it is determined later that the transaction should have been disclosed as a Micro-captive Transaction of Interest.

Proposed § 1.6011-11(e)(1) provides the rules for determining who is a participant in a transaction of interest described in proposed § 1.6011-11(a). Proposed § 1.6011-11(e)(2) provides a safe harbor from the disclosure requirements for certain persons. *See* section B.5. of this Explanation of Provisions.

Proposed § 1.6011-11(f) describes information that participants must provide to satisfy the disclosure requirements of § 1.6011-4(d) by reference to the information described in proposed § 1.6011-10(f). *See* section B.4. of this Explanation of Provisions.

Proposed § 1.6011-11(g) provides the applicability date for the proposed regulations.

B. Changes to Transaction Identified in Notice 2016-66

Examinations of taxpayers and promoters and information received through disclosures filed in response to Notice 2016-66 have clarified the Treasury Department's and the IRS's understanding of micro-captive transactions, including the scope of participation. Based on such information, the Treasury Department and the IRS have determined that certain changes to the micro-captive transaction identified in Notice 2016-66 are appropriate for the proposed regulations. The transactions described in proposed § 1.6011-10 and proposed § 1.6011-11 share common features with the micro-captive transactions described in Notice 2016-66, but with modifications to the scope of the 20-percent relationship factor and the factors used to distinguish between listed transactions, transactions of interest, and transactions that are not reportable transactions under the proposed regulations.

1. Changes to the Definition of Captive

The Treasury Department and the IRS are aware that some promoters have structured transactions in which Insureds, Owners, or persons Related to an Insured or an Owner do not have a direct or indirect interest in Captive's voting power or value of its outstanding stock or equity interests, but have a relationship with Captive that provides substantially similar benefits and risks. For example, Captive may issue various types of instruments representing rights to all or a portion of the assets held by Captive but not rights to the voting power or equity interests in Captive. All equity interests and voting stock are held by individuals or entities related to the promoter, not the taxpayers. The promoters thereby seek to avoid the 20 percent related interest in the voting stock or equity interests in Captive necessary for a transaction to be described in Notice 2016-66. The proposed regulations expand the scope of the definition of Captive to clarify that derivatives and interests in the assets of Captive are taken into account. *See* proposed §§1.6011-10(b)(1)(A)–(C) and 1.6011-11(b)(1).

2. Changes to the Financing Factor

Transactions in which the financing factor is met based on a computation period of Captive's most recent five taxable years (or all years of Captive's existence if Captive has been in existence for less than five taxable years), referred to as the Financing Computation Period in the proposed regulations, are identified as transactions of interest in Notice 2016-66 but are identified as listed transactions in the proposed regulations.

See proposed § 1.6011-10(c)(1). Presence of the financing factor in related party micro-captive insurance transactions indicates tax avoidance and abuse of Captive's status as a section 831(b)-electing insurance company.

3. Changes to the Loss Ratio Factor and Computation Period

Notice 2016-66 identifies transactions in which the loss ratio factor is less than 70 percent based on a Notice Computation Period of Captive's most recent five taxable years (or all years of Captive's existence if it has been in existence for less than five taxable years) as transactions of interest. The proposed regulations, however, identify as listed transactions those transactions in which the loss ratio factor is less than 65 percent for a computation period extended to Captive's most recent ten taxable years (referred to as the Loss Ratio Computation Period). *See* proposed § 1.6011-10(c)(2). Further, the proposed regulations identify transactions in which the loss ratio factor is less than 65 percent based on a Transaction of Interest Computation Period consisting of Captive's most recent nine taxable years (or all years of Captive's existence if Captive has been in existence for less than nine taxable years) as transactions of interest. *See* proposed § 1.6011-11(c).

Regarding the reduction of the loss ratio threshold from 70 percent to 65 percent, the Treasury Department and the IRS are not aware of any non-abusive transactions for which disclosure was required under Notice 2016-66 as a result of the 70-percent loss ratio factor set forth therein. Nevertheless, for purposes of the proposed regulations and to ensure that disclosure is not required for non-abusive transactions, the Treasury Department and the IRS are lowering the applicable loss ratio factor to 65 percent. *See* proposed §§ 1.6011-10(c)(2) and 1.6011-11(c). The loss ratio factor helps to identify transactions involving circumstances inconsistent with insurance in the commonly accepted sense, including excessive pricing of premiums and artificially low or nonexistent claims activity. The primary purpose of premium pricing is to ensure funds are available should a claim arise. The pricing of premiums should naturally reflect the economic reality of insurance operations. Pricing premiums far in excess of what is reasonably needed to fund insurance operations results in a lower loss ratio and is a strong indicator of abuse. Any Captives that would be required to disclose as a result of the loss ratio factor may consider paying policy-holder dividends to increase the loss ratio and eliminate the need to disclose.

The Treasury Department and the IRS are considering whether a combined ratio may be a better indicator for distinguishing abusive transactions from other captive transactions. A combined ratio is “an indication of the profitability of an insurance company, calculated by adding the loss and expense ratios.” *NAIC Glossary of Insurance Terms, https://content.naic.org/consumer_glossary#C* (last visited April 3, 2023). The 2021 NAIC P&C Report provides that the combined ratios for property and casualty insurance companies ranged from 96 percent to 103.9 percent over the ten-year period from 2012 to 2021, for a ten-year average of approximately 99.5 percent. *See U.S. Property & Casualty and Title Insurance Industries—2021 Full Year Results* (2022), *https://content.naic.org/sites/default/files/inline-files/2021%20Annual%20Property%20%26%20Casualty%20and%20Title%20Insurance%20Industry%20Report.pdf* (last visited April 3, 2023). The combined ratio would compare losses incurred, plus loss adjustment expenses incurred and other underwriting expenses incurred by Captive during the relevant computation period to Captive's earned premiums, less policyholder dividends, for the relevant computation period. For this purpose, Captive's other underwriting expenses incurred would equal Captive's expenses incurred in carrying on an insurance business, other than loss adjustment expenses and investment-related expenses. Transactions in which Captive's combined ratio is less than a certain percentage for a Loss Ratio Computation Period of the most recent ten taxable years of Captive would be identified as listed transactions. Transactions in which Captive's combined ratio is less than a certain percentage for a Transaction of Interest Computation Period of the most recent nine taxable years (or all years of Captive's existence if it has been in existence for less than nine taxable years) would be identified as transactions of interest. The Treasury Department and the

IRS invite comments on whether a combined ratio would better distinguish abusive transactions than the proposed loss ratio factor, and if so, what combined ratio threshold would be most effective in distinguishing abusive transactions.

Regarding the computation periods for the loss ratio factor, the Treasury Department and the IRS understand that it is possible that a Captive with a loss history of fewer than ten taxable years could have a loss ratio that falls below 65 percent solely because Captive provides coverage for low frequency, high severity losses and Insureds purchasing policies from such Captive do not incur such losses in every year. In recognition of this fact, the proposed regulations categorize transactions as either transactions of interest or listed transactions based on the length of the computation period on which the loss ratio is based. The Notice Computation Period used by Notice 2016-66 to identify transactions of interest based on a loss ratio factor was five taxable years, and it has been more than five years since Notice 2016-66 was published. The Treasury Department and the IRS have determined that extending the computation period by five years to a Loss Ratio Computation Period of ten taxable years (doubling the Notice Computation Period) allows Captives significant time to develop a reasonable loss history that supports the use of Captive for legitimate insurance purposes, and a loss ratio that remains below 65 percent for a Loss Ratio Computation Period of ten taxable years indicates a tax avoidance transaction. Accordingly, the proposed regulations identify transactions in which the loss ratio is less than 65 percent based on an extended Loss Ratio Computation Period of Captive's most recent ten taxable years as listed transactions. *See* proposed § 1.6011-10(b)(2).

However, the Treasury Department and the IRS also have determined that related party transactions in which the loss ratio is less than 65 percent over a shorter period of time have a potential for tax avoidance or evasion. The proposed regulations therefore identify transactions in which Captive has a loss ratio of less than 65 percent based on a Transaction of Interest Computation Period of Captive's most recent nine taxable years (or all years of Captive's existence if it has been in existence for less than nine taxable years) as transactions of interest, provided such transactions are not otherwise characterized as listed transactions (that is, due to the presence of the financing factor described in proposed § 1.6011-10(c)(1) or due to having a loss ratio factor of less than 65 percent based on a Loss Ratio Computation Period of Captive's most recent ten taxable years). *See* proposed § 1.6011-11(c) and (d)(3). Identification of these transactions as transactions of interest will permit the Treasury Department and the IRS to gather more information to determine if these transactions are being used for tax avoidance or evasion.

4. Information Sought From Participants

The proposed regulations significantly reduce the information required to be reported by Captives under § 1.6011-4(d) as compared to Notice 2016-66. *See* proposed §§ 1.6011-10(f) and 1.6011-11(f). Unlike Notice 2016-66, the proposed regulations do not require Captive participants to identify which factors of the proposed regulations apply, state under what authority Captive is chartered, describe how amounts treated as premiums for coverage provided by Captive were determined, provide the amounts of reserves reported by Captive on its annual statement, or describe the assets held by Captive. The proposed regulations do, however, require Captive to identify the types of policies issued or reinsured, the amounts treated as premiums written, the name and contact information of actuaries and underwriters involved, and the total amount of claims paid by Captive. Additionally, proposed §§ 1.6011-10(b)(1) and 1.6011-11(b)(1) include a 20-percent relationship test in the definition of Captive, and the proposed regulations require Captive participants to identify the name and percentage of interest held directly or indirectly by each person whose interest in Captive meets the 20 percent threshold or is taken into account in meeting the 20 percent threshold under proposed § 1.6011-10(b)(1)(iii). Also, the proposed regulations require each Insured (as defined in proposed §§ 1.6011-10(b)(4) and 1.6011-11(b)(4)) subject to the disclosure requirements set forth

in § 1.6011-4(d) to provide the amounts treated by Insured as insurance premiums for coverage provided to Insured, directly or indirectly, by Captive.

5. Disclosure Requirement Safe Harbor for Owners

The Treasury Department and the IRS believe that it is now feasible to generally limit the persons from whom reporting would be required under the proposed regulations to Captive, Insured, and material advisors to the transaction. Accordingly, the proposed regulations provide that any person who, solely by reason of their direct or indirect ownership interest in Insured, is subject to the disclosure requirements set forth in § 1.6011-4 as a participant in a Micro-captive Listed Transaction or a Micro-captive Transaction of Interest, is not required under § 1.6011-4 to file a disclosure statement with respect to that transaction provided that person receives written or electronic acknowledgment that Insured has or will comply with its separate disclosure obligation under § 1.6011-4(a) with respect to the transaction. *See* proposed §§ 1.6011-10(e)(2) and 1.6011-11(e)(2). The acknowledgment can be a copy of the Form 8886, *Reportable Transaction Disclosure Statement* (or successor form), filed (or to be filed) by Insured and must be received by Owner prior to the time set forth in § 1.6011-4(e) in which Owner would otherwise be required to provide disclosure. *See* proposed §§ 1.6011-10(e)(2) and 1.6011-11(e)(2). However, the receipt of an acknowledgment that Insured has or will comply with its disclosure obligation does not relieve the Owners of Insured of their disclosure obligations if Insured fails to disclose the transaction in a timely manner.

6. Exception for Consumer Coverage Arrangements

The proposed regulations provide a limited exception from classification as a Micro-captive Listed Transaction or Micro-captive Transaction of Interest for certain Consumer Coverage reinsurance arrangements. *See* proposed §§ 1.6011-10(d)(2) and 1.6011-11(d)(2). In Consumer Coverage arrangements, a “Seller” (that is, a service provider, automobile dealer, lender, or retailer) sells products or services to “Unrelated Customers” (that is, customers who do not own an interest in and are not wholly or partially owned by Seller, an owner of Seller, or individuals or entities related (within the meaning of one or more of sections 267(b), 707(b), 2701(b)(2)(C), or 2704(c)(2)) to Seller or owners of Seller). An Unrelated Customer may also purchase an insurance contract in connection with those products or services (Consumer Coverage contract). The Consumer Coverage contract generally provides coverage for repair or replacement costs if the product breaks down or is lost, stolen, or damaged; coverage for the customer's payment obligations if the customer dies or becomes disabled or unemployed; coverage for the difference between all or a portion of the value of the product and the amount owed on the product's financing, including a lease, if the product suffers a covered peril; or a combination of one or more of the foregoing types of coverage.

An entity related to or affiliated with Seller may issue or reinsure the Consumer Coverage contracts. In some arrangements, the Consumer Coverage contracts name an unrelated third party, which may be referred to as a “Fronting Company,” as the provider of the coverage, and an entity related to or affiliated with Seller reinsures the Consumer Coverage contracts. In other arrangements, the Consumer Coverage contracts may name an entity related to or affiliated with Seller as the provider of the coverage. In these arrangements, an unrelated third party may reinsure the contracts and may also then retrocede risk under the contracts to the entity related to or affiliated with Seller. The parties may treat the entity related to or affiliated with Seller as an insurance company that elects under section 831(b) (and section 953(d) if the corporation is foreign) to exclude premium payments from taxable income.

As a general matter, participation in this type of reinsurance arrangement is neither a Micro-captive Listed Transaction nor a Micro-captive Transaction of Interest because the insured is not sufficiently related to the insurer or any reinsurer. Generally, the Consumer Coverage contracts insure Unrelated Customers of Seller,

and Unrelated Customers, their owners, and persons related to Unrelated Customers or their owners do not directly or indirectly own at least 20 percent of the voting power or value of the outstanding stock of any entity issuing or reinsuring the Consumer Coverage contract. However, the 20-percent relationship factor in proposed §§ 1.6011-10(b)(1) and 1.6011-11(b)(1) may be met in some of these reinsurance arrangements. For instance, in “dealer obligor” arrangements in which the Seller would be legally required to pay a claim under certain conditions, such as a total loss of the covered product within a certain time frame, the Seller could potentially be considered an Insured under a Contract issued or reinsured by a Captive, and thus be required to disclose.

The Treasury Department and the IRS have determined that a limited exception for taxpayers in Consumer Coverage arrangements is appropriate, provided commissions paid for Consumer Coverage contracts issued or reinsured by the Seller's Captive are comparable to the commissions paid for Consumer Coverage contracts covering Seller's products or services that are not issued or reinsured by the Seller's Captive. *See* proposed §§ 1.6011-10(d)(2) and 1.6011-11(d)(2).

C. Effect of Transaction Becoming a Listed Transaction or a Transaction of Interest Under These Regulations

Participants required to disclose these transactions under § 1.6011-4 who fail to do so are subject to penalties under section 6707A. Participants required to disclose the listed transactions under § 1.6011-4 who fail to do so are also subject to an extended period of limitations under section 6501(c)(10). Material advisors required to disclose these transactions under section 6111 who fail to do so are subject to the penalty under section 6707. Material advisors required to maintain lists of investors under section 6112 who fail to do so (or who fail to provide such lists when requested by the IRS) are subject to the penalty under section 6708(a). In addition, the IRS may impose other penalties on persons involved in these transactions or substantially similar transactions, including accuracy-related penalties under section 6662 or section 6662A, the section 6694 penalty for understatements of a taxpayer's liability by a tax return preparer, the section 6700 penalty for promoting abusive tax shelters, and the section 6701 penalty for aiding and abetting understatement of a tax liability.

Taxpayers who have filed a tax return (including an amended return (or Administrative Adjustment Request (AAR) for certain partnerships)) reflecting their participation in these transactions prior to the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register** and who have not otherwise finalized a settlement agreement with the Internal Revenue Service with respect to the transaction must disclose the transactions as provided in § 1.6011-4(d) and (e) provided that the period of limitations for assessment of tax, including any applicable extensions, for any taxable year in which the taxpayer participated in the transaction has not ended on or before the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register.**

In addition, material advisors have disclosure requirements with regard to transactions occurring in prior years. However, notwithstanding § 301.6111-3(b)(4)(i) and (iii), material advisors are required to disclose only if they have made a tax statement on or after six years before the date of the Treasury decision adopting these regulations as final regulations is published in the **Federal Register.**

A participant in a transaction that is a Micro-captive Listed Transaction must file a disclosure statement with OTSA when required to do so under § 1.6011-4(e), regardless of whether the participant has previously disclosed the transaction to OTSA pursuant to Notice 2016-66. A participant in a transaction that is a Micro-captive Transaction of Interest that has previously filed a disclosure statement with OTSA pursuant to Notice 2016-66 will be treated as having made the disclosure pursuant to the final regulations for taxable years for which the taxpayer filed returns before the final regulations are published in the **Federal Register.** However, if

a taxpayer described in the preceding sentence participates in the Micro-captive Transaction of Interest in a taxable year for which the taxpayer files a return on or after the date the final regulations are published in the **Federal Register,** the taxpayer must file a disclosure statement with OTSA at the same time the taxpayer files their return for the first such taxable year.

A material advisor with respect to a transaction that is a Micro-captive Listed Transaction or Micro-captive Transaction of Interest must file a disclosure statement with OTSA when required to do so under § 301.6111-3(e), regardless of whether the material advisor has previously disclosed the transaction to OTSA pursuant to Notice 2016-66.

The Treasury Department and the IRS recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the types of transactions described in these proposed regulations. Because the IRS will take the position that taxpayers are not entitled to the purported tax benefits of the listed transactions described in the proposed regulations, and may take such a position with respect to the transactions of interest described in the proposed regulations, taxpayers should consider filing amended returns or AARs for certain partnerships and ensure that their transactions are disclosed properly. Taxpayers filing an amended individual return should write “Microcaptive” at the top of the first page of the amended return and mail the amended return to: Internal Revenue Service, 2970 Market Street, Philadelphia, PA 19104.

Taxpayers filing amended business returns on paper should write “Microcaptive” at the top of the first page of the amended return and mail to the address listed in the instructions for the amended return. Taxpayers filing amended business returns electronically should include “Microcaptive” when explaining the reason for the changes.

Proposed Applicability Dates

Proposed § 1.6011-10(a) would identify certain micro-captive transactions described in proposed § 1.6011-10(c) as listed transactions effective as of the date of publication in the **Federal Register** of a Treasury decision adopting these regulations as final regulations. Similarly, proposed § 1.6011-11(a) would identify certain micro-captive transactions described in proposed § 1.6011-11(c) as transactions of interest as of the date of publication in the **Federal Register** of a Treasury decision adopting these regulations as final regulations.

Effect on Other Documents

This document obsoletes Notice 2016-66 (2016-47 I.R.B. 745), as modified by Notice 2017-08 (2017-3 I.R.B. 423), as of April 11, 2023.

Special Analyses

I. Regulatory Planning and Review

The proposed regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB) regarding the review of tax regulations.

II. Paperwork Reduction Act

The collection of information contained in these proposed regulations is reflected in the collection of information for Forms 8886 and 8918 that have been reviewed and approved by OMB in accordance with the

Paperwork Reduction Act (44 U.S.C. 3507(c)) under control numbers 1545-1800 and 1545-0865. Any disclosures with respect to the safe harbor for owners as provided in §§ 1.6011-10(e)(2) and 1.6011-11(e)(2) are in the nature of an acknowledgment per 5 CFR 1320.3(h)(1), and therefore do not constitute a collection of information under the Paperwork Reduction Act.

To the extent there is a change in burden as a result of these regulations, the change in burden will be reflected in the updated burden estimates for the Forms 8886 and 8918. The requirement to maintain records to substantiate information on Forms 8886 and 8918 is already contained in the burden associated with the control numbers for the forms and is unchanged.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by OMB.

III. Regulatory Flexibility Act

The Secretary of the Treasury hereby certifies that the proposed regulations will not have a significant economic impact on a substantial number of small entities pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

As previously explained, the basis for these proposed regulations is Notice 2016-66, 2016-47 I.R.B. 745 (as modified by Notice 2017-08, 2017-3 I.R.B. 423). The following chart sets forth the gross receipts of respondents to Notice 2016-66, based on data for tax year 2020:

NOTICE 2016-66 RESPONDENTS BY SIZE

Receipts	Firms (percent)	Filings (percent)
Under 5M	78.65	75.26
5M to 10M	9.36	10.20
10M to 15M	4.39	5.10
15M to 20M	2.34	2.55
20M to 25M	1.17	1.53
Over 25M	4.09	5.36
Total	100	100

This chart shows that the majority of respondents reported gross receipts under $5 million. Even assuming that these respondents constitute a substantial number of small entities, the proposed regulations will not have a significant economic impact on these entities because the proposed regulations implement sections 6111 and 6112 and § 1.6011-4 by specifying the manner in which and time at which an identified Micro-captive Listed Transaction or Micro-captive Transaction of Interest must be reported. Accordingly, because the regulations are limited in scope to time and manner of information reporting and definitional information, the economic impact of the proposal is expected to be minimal.

Further, the Treasury Department and the IRS expect that the reporting burden is low; the information sought is necessary for regular annual return preparation and ordinary recordkeeping. The estimated burden for any taxpayer required to file Form 8886 is approximately 10 hours, 16 minutes for recordkeeping, 4 hours, 50 minutes for learning about the law or the form, and 6 hours, 25 minutes for preparing, copying, assembling, and sending the form to the IRS. The IRS's Research, Applied Analytics, and Statistics division estimates that

the appropriate wage rate for this set of taxpayers is $77.50 (2020 dollars) per hour. Thus, it is estimated that a respondent will incur costs of approximately $1,667.27 per filing. Disclosures received to date by the Treasury Department and the IRS in response to the reporting requirements of Notice 2016-66 indicate that this small amount will not pose any significant economic impact for those taxpayers now required to disclose under the proposed regulations.

For the reasons stated, a regulatory flexibility analysis under the Regulatory Flexibility Act is not required. The Treasury Department and the IRS invite comments on the impact of the proposed regulations on small entities. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million (updated annually for inflation). This proposed rule does not include any Federal mandate that may result in expenditures by State, local, or Tribal governments or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. This proposed rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive order.

Comments and Public Hearing

Before these proposed amendments to the regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in the preamble under the **ADDRESSES** section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. The Treasury Department and the IRS specifically request comments on the following:

1. What are the specific and objective metrics, factors, or standards, if any, that, if reported, would allow for the IRS to better identify and distinguish abusive micro-captive transactions from other micro-captive transactions?

2. With respect to proposed §§ 1.6011-10(c)(2) and 1.6011-11(c), whether the loss ratio described therein, which compares “the amount of liabilities incurred by Captive for insured losses and claim administration expenses during the [applicable] Computation Period” to the “premiums earned by Captive during the [applicable] Computation Period less policyholder dividends paid by Captive during the [applicable] Computation Period”, should be replaced by a combined ratio, which compares “losses incurred, plus loss adjustment expenses incurred and other underwriting expenses incurred by Captive during the [applicable] Computation Period” to “Captive's earned premiums, less policyholder dividends, for the [applicable] Computation Period”, and if so, what percentage would be an effective threshold for purposes of identifying abusive transactions. For this purpose, Captive's “other underwriting expenses incurred” would equal

Captive's expenses incurred in carrying on an insurance business, other than loss adjustment expenses and investment-related expenses.

3. With respect to the percentage of premiums retained as commissions for contracts as described at proposed §§ 1.6011-10(d)(2) and 1.6011-11(d)(2), what, if any, are the specific metrics, factors, or standards that, if reported, would allow for the IRS to better identify and distinguish abusive micro-captive transactions of this type from other such micro-captive transactions?

Any comments submitted will be made available at *https://www.regulations.gov* or upon request.

A public hearing is scheduled to be held by teleconference on July 19, 2023, beginning at 10:00 a.m. ET unless no outlines are received by June 12, 2023.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to comment by telephone at the hearing must submit written or electronic comments and an outline of the topics to be discussed as well as the time to be devoted to each topic by June 12, 2023 as prescribed in the preamble under the **ADDRESSES** section.

A period of ten minutes will be allocated to each person for making comments. After the deadline for receiving outlines has passed, the IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available at *https://www.regulations.gov,* search IRS and REG-109309-22. Copies of the agenda will also be available by emailing a request to *publichearings@irs.gov.* Please put "REG-109309-22 Agenda Request" in the subject line of the email.

Announcement 2020-4, 2020-17 I.R.B. 667 (April 20, 2020), provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Statement of Availability of IRS Documents

The notices and revenue ruling cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *https://www.irs.gov.*

Drafting Information

The principal author of these proposed regulations is Elizabeth M. Hill, Office of Associate Chief Counsel (Financial Institutions & Products). However, other personnel from the Treasury Department and the IRS participated in the development of these regulations.

List of Subjects in 26 CFR Part 1

Income Taxes, Reporting and recordkeeping requirements.

Preamble of Proposed Regulation

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Section 1.6011-10 also issued under 26 U.S.C. 6001 and 26 U.S.C. 6011.

Section 1.6011-11 also issued under 26 U.S.C. 6001 and 26 U.S.C. 6011.

* * * * *

Par. 2. Section 1.6011-10 is added to read as follows:

§ 1.6011-10 Micro-captive listed transaction. —

(a) *Identification as listed transaction.* Transactions that are the same as, or substantially similar to, transactions described in paragraph (c) of this section are identified as listed transactions for purposes of § 1.6011-4(b)(2), except as provided in paragraph (d) of this section.

(b) *Definitions.* The following definitions apply for purposes of this section:

(1) *Captive* means any entity that:

(i) Elects under section 831(b) of the Internal Revenue Code (Code) to exclude premiums from taxable income;

(ii) Issues a Contract to an Insured, reinsures a Contract of an Insured issued by an Intermediary, or both; and

(iii) Has at least 20 percent of its assets or the voting power or value of its outstanding stock or equity interests directly or indirectly owned, individually or collectively, by an Insured, an Owner, or persons Related to an Insured or an Owner. For purposes of this paragraph (b)(1)(iii), the following rules apply to the extent application of a rule (or rules) would increase such direct or indirect ownership:

(A) A person that holds a derivative is treated as indirectly owning the assets referenced by the derivative; and

(B) The interest of each beneficiary of a trust or estate in the assets of such trust or estate must be determined by assuming the maximum exercise of discretion by the fiduciary in favor of such beneficiary and the maximum use of the trust's or estate's interest in the company to satisfy the interests of such beneficiary.

(2) *Computation periods*—

(i) *Financing Computation Period.* The Financing Computation Period is the most recent five taxable years of Captive (or all taxable years of Captive, if Captive has been in existence for less than five taxable years).

(ii) *Loss Ratio Computation Period.* The Loss Ratio Computation Period is the most recent ten taxable years of Captive. A Captive that does not have at least ten taxable years cannot have a Loss Ratio Computation Period, and therefore is not described in paragraph (c)(2) of this section.

(iii) *Rules for computation periods.* This paragraph (b)(2)(iii) applies for purposes of determining the Financing Computation Period and the Loss Ratio Computation Period. Each short taxable year is a separate taxable year. If Captive is a successor to one or more other Captives, taxable years of each such other Captive are treated as taxable years of Captive. A successor is any of the following:

(A) A successor corporation as defined in § 1.382-2(a)(5);

(B) An entity that, directly or indirectly, acquires (or is deemed to acquire) the assets of another entity and succeeds to and takes into account the other entity's earnings and profits or deficit in earnings and profits; or

(C) An entity that receives (or is deemed to receive) any assets from another entity if such entity's basis is determined, directly or indirectly, in whole or in part, by reference to the other entity's basis.

(3) *Contract* means any contract that is treated by a party to the contract as an insurance contract or reinsurance contract for Federal income tax purposes.

(4) *Insured* means any person that conducts a trade or business, enters into a Contract with a Captive or enters into a Contract with an Intermediary that is directly or indirectly reinsured by a Captive, and treats amounts paid under the Contract as insurance premiums for Federal income tax purposes.

(5) *Intermediary* means any entity that issues a Contract to an Insured, or reinsures a Contract that is issued to an Insured, and such Contract is reinsured, directly or indirectly, by a Captive. A transaction may have more than one Intermediary.

(6) *Owner* means any person who, directly or indirectly, holds an ownership interest in an Insured or its assets. For purposes of this paragraph (b)(6), the following rules apply to the extent application of a rule (or rules) would increase such direct or indirect ownership:

(i) The interest of a person that holds a derivative must be determined as provided in paragraph (b)(1)(iii)(A) of this section; and

(ii) The interest of each beneficiary of a trust or estate in the assets of such trust or estate must be determined as provided in paragraph (b)(1)(iii)(B) of this section.

(7) *Recipient* means any Owner, Insured, or person Related to an Owner or an Insured engaged in a transaction described in paragraph (c)(1) of this section.

(8) *Related* means having a relationship described in one or more of sections 267(b), 707(b), 2701(b)(2)(C), and 2704(c)(2) of the Code.

(9) *Seller* means a service provider, automobile dealer, lender, or retailer that sells products or services to Unrelated Customers who purchase insurance contracts in connection with those products or services.

(10) *Seller's Captive* means a Captive Related to Seller, an owner of Seller, or individuals or entities Related to Seller or owners of Seller.

(11) *Unrelated Customers* means persons who do not own an interest in, and are not wholly or partially owned by, Seller, an owner of Seller, or individuals or entities Related to Seller or owners of Seller.

(c) *Transaction description.* A transaction is described in this paragraph (c) if the transaction is described in paragraph (c)(1) of this section, paragraph (c)(2) of this section, or both.

(1) The transaction involves a Captive that, at any time during the Financing Computation Period, directly or indirectly made available as financing or otherwise conveyed or agreed to make available or convey to a Recipient, in a transaction that did not result in taxable income or gain to the Recipient, any portion of the payments under the Contract, such as through a guarantee, a loan, or other transfer of Captive's capital, or made such financings or conveyances prior to the Financing Computation Period that remain outstanding or in effect at any point in the taxable year for which disclosure is required. Any amounts that a Captive made available as financing or otherwise conveyed or agreed to make available or convey to a Recipient are presumed to be portions of the payments under the Contract to the extent such amounts when made available or conveyed are in excess of Captive's cumulative after-tax net investment earnings minus any outstanding financings or conveyances.

(2) The transaction involves a Captive for which the amount of liabilities incurred for insured losses and claim administration expenses during the Loss Ratio Computation Period is less than 65 percent of the amount equal to premiums earned by Captive during the Loss Ratio Computation Period less policyholder dividends paid by Captive during the Loss Ratio Computation Period.

(d) *Exceptions.* A transaction described in paragraph (c) of this section is not classified as a listed transaction for purposes of this section and § 1.6011-4(b)(2) if the transaction:

(1) Provides insurance for employee compensation or benefits and is one for which the Employee Benefits Security Administration of the U.S. Department of Labor has issued a Prohibited Transaction Exemption under the procedures provided at 76 FR 66637 (Oct. 27, 2011) (or subsequent procedures); or

(2) Is an arrangement in which a Captive meets all of the following requirements:

(i) Captive is a Seller's Captive,

(ii) The Seller's Captive issues or reinsures some or all of the Contracts sold to Unrelated Customers in connection with the products or services being sold by the Seller,

(iii) 100 percent of the business of the Seller's Captive is insuring or reinsuring Contracts in connection with products or services being sold by the Seller or persons Related to the Seller, and

(iv) With respect to the Contracts issued or reinsured by the Seller's Captive, the fee, commission, or other remuneration earned by any person or persons, in the aggregate, for the sale of the Contracts, described as a percentage of the premiums paid by the Seller's customers, is at least equal to the greater of:

(A) 50 percent; or

(B) The unrelated commission percentage (which is the highest percentage fee, commission, or other remuneration known to the Seller that is earned by any person or persons, in the aggregate, for the sale of any extended warranty, insurance, or other similar Contract sold to a customer covering products or services sold by the Seller.

(e) *Special participation rules—*

(1) *In general.* Whether a taxpayer has participated in the listed transaction identified in paragraph (a) of this section will be determined under § 1.6011-4(c)(3)(i)(A). Participants include, but are not limited to, any Owner, Insured, Captive, or Intermediary with respect to the transaction whose tax return reflects tax consequences or a tax strategy described in paragraph (a) of this section, except as otherwise provided in paragraph (e)(2) of this section.

(2) *Disclosure safe harbor for Owners.* An Owner who, solely by reason of the Owner's direct or indirect ownership interest in an Insured, has participated in the listed transaction described in this section will not be required to disclose participation in the transaction under section 6011(a), notwithstanding § 1.6011-4(c)(3), if the Owner receives an acknowledgement, in writing or electronically, from the Insured that the Insured has or will comply with the Insured's separate disclosure obligation under § 1.6011-4 with respect to the transaction and the Insured discloses the transaction in a timely manner. The acknowledgment can be a copy of the Form 8886, *Reportable Transaction Disclosure Statement* (or successor form), filed (or to be filed) by the Insured and must be received by the Owner prior to the time set forth in § 1.6011-4(e) in which the Owner would otherwise be required to provide disclosure. Owners who meet the requirements of this safe harbor will not be treated as having participated in an undisclosed listed transaction for purposes of § 1.6664-2(c)(3)(ii) or as having failed to include information on any return or statement with respect to a listed transaction for purposes of section 6501(c)(10).

(f) *Disclosure requirements—*

(1) *Information required of all participants.* Participants must provide the information required under § 1.6011-4(d) and the Instructions to Form 8886 (or successor form). For all participants, describing the transaction in sufficient detail includes, but is not limited to, describing on Form 8886 (or successor form) when, how, and from whom the participant became aware of the transaction, and how the participant participated in the transaction (for example, as an Insured, a Captive, or other participant). Paragraphs (f)(2) and (3) of this section describe information required of a Captive and an Insured, respectively.

(2) *Information required of a Captive.* For a Captive, describing the transaction in sufficient detail includes, but is not limited to, describing the following on Form 8886 (or successor form):

(i) All the type(s) of policies issued or reinsured by Captive during the year of participation or years of participation (if disclosure pertains to multiple years);

(ii) The amounts treated by Captive as premiums written for coverage provided by Captive during the year of participation or each year of participation (if disclosure pertains to multiple years);

(iii) The name and contact information of each and every actuary or underwriter who assisted in the determination of the amounts treated as premiums for coverage provided by Captive during the year or each year of participation (if disclosure pertains to multiple years);

(iv) The total amount of claims paid by Captive during the year of participation or each year of participation (if disclosure pertains to multiple years); and

(v) The name and percentage of interest directly or indirectly held by each person whose interest in Captive meets the 20 percent threshold or is taken into account in meeting the 20 percent threshold under § 1.6011-10(b)(1)(iii).

(3) *Information required of Insured.* For Insured, describing the transaction in sufficient detail includes, but is not limited to, describing on Form 8886 (or successor form) the amounts treated by Insured as premiums for coverage provided to Insured, directly or indirectly, by Captive or by each Captive (if disclosure pertains to multiple Captives) during the year or each year of participation (if disclosure pertains to multiple years), as well as the identity of all persons identified as Owners to whom the Insured provided an acknowledgment described in paragraph (e)(2) of this section.

(g) *Applicability date*—

(1) *In general.* This section identifies transactions that are the same as, or substantially similar to, the transactions described in paragraph (a) of this section as listed transactions for purposes of § 1.6011-4(b)(2) effective the date the regulations are published as final regulations in the **Federal Register.**

(2) *Obligations of participants with respect to prior periods.* Pursuant to § 1.6011-4(d) and (e), taxpayers who have filed a tax return (including an amended return) reflecting their participation in transactions described in paragraph (a) of this section prior to the date these regulations are published as final regulations in the **Federal Register,** who have not otherwise finalized a settlement agreement with the Internal Revenue Service with respect to the transaction, must disclose the transactions as required by § 1.6011-4(d) and (e) provided that the period of limitations for assessment of tax (as determined under section 6501 of the Code, including section 6501(c)) for any taxable year in which the taxpayer participated has not ended on or before the date the regulations are published as final regulations in the **Federal Register.**

(3) *Obligations of material advisors with respect to prior periods.* Material advisors defined in § 301.6111-3(b) of this chapter who have previously made a tax statement with respect to a transaction described in paragraph (a) of this section have disclosure and list maintenance obligations as described in §§ 301.6111-3 and 301.6112-1 of this chapter, respectively. Notwithstanding § 301.6111-3(b)(4)(i) and (iii) of this chapter, material advisors are required to disclose only if they have made a tax statement on or after the date that is six years before the date the regulations are published as final regulations in the **Federal Register.** Material advisors that are uncertain whether the transaction they are required to disclose should be reported under this section or § 1.6011-11 should disclose under this section, and will not be required to disclose a

second time if it is later determined that the transaction should have been disclosed under § 1.6011-11.

Par. 3. Section 1.6011-11 is added to read as follows:

§ 1.6011-11 Micro-captive transaction of interest. —

(a) *Identification as transaction of interest.* Transactions that are the same as, or substantially similar to, transactions described in paragraph (c) of this section are identified as transactions of interest for purposes of § 1.6011-4(b)(6), except as provided in paragraph (d) of this section.

(b) *Definitions.* The following definitions apply for purposes of this section:

(1) *Captive* has the same meaning as provided in § 1.6011-10(b)(1).

(2) *Transaction of Interest Computation Period* means the most recent nine taxable years of a Captive (or all taxable years of Captive, if Captive has been in existence for less than nine taxable years). For purposes of this paragraph (b)(2), each short taxable year is a separate taxable year, and if Captive is a successor to one or more other Captives, taxable years of each such other Captive are treated as taxable years of Captive. A successor has the same meaning as provided in § 1.6011-10(b)(2)(iii) for purposes of this paragraph (b)(2).

(3) *Contract* has the same meaning as provided in § 1.6011-10(b)(3).

(4) *Insured* has the same meaning as provided in § 1.6011-10(b)(4).

(5) *Intermediary* has the same meaning as provided in § 1.6011-10(b)(5).

(6) *Owner* has the same meaning as provided in § 1.6011-10(b)(6).

(7) *Related* has the same meaning as provided in § 1.6011-10(b)(8).

(8) *Seller* has the same meaning as provided in § 1.6011-10(b)(9).

(9) *Seller's Captive* has the same meaning as provided in § 1.6011-10(b)(10).

(10) *Unrelated Customers* has the same meaning as provided in § 1.6011-10(b)(11).

(c) *Transaction description.* A transaction is described in this paragraph (c) if the transaction involves a Captive for which the amount of liabilities incurred for insured losses and claim administration expenses during the Transaction of Interest Computation Period is less than 65 percent of the amount equal to premiums earned by Captive during the Transaction of Interest Computation Period less policyholder dividends paid by Captive during the Transaction of Interest Computation Period.

(d) *Exceptions.* A transaction described in paragraph (c) of this section is not classified as a transaction of interest for purposes of this section and § 1.6011-4(b)(6) if the transaction:

(1) Is described in § 1.6011-10(d)(1);

(2) Is described in § 1.6011-10(d)(2); or

(3) Is identified as a listed transaction in § 1.6011-10(a), in which case the transaction must be reported as a listed transaction under § 1.6011-10.

(e) *Special participation rules*—

(1) *In general.* Whether a taxpayer has participated in the transaction of interest identified in paragraph (a) of this section will be determined under § 1.6011-4(c)(3)(i)(E). Participants include, but are not limited to, any Owner, Insured, Captive, or Intermediary with respect to the transaction whose tax return reflects tax consequences or a tax strategy described in paragraph (a) of this section, except as otherwise provided in paragraph (e)(2) of this section.

(2) *Disclosure safe harbor for Owners.* An Owner who, solely by reason of the Owner's direct or indirect ownership interest in an Insured, has participated in the transaction of interest described in this section will not be required to disclose participation in the transaction under section 6011(a), notwithstanding § 1.6011-4(c)(3), if the Owner receives acknowledgment, in writing or electronically, from the Insured that the Insured has or will comply with Insured's separate disclosure obligation under § 1.6011-4 with respect to the transaction and the Insured discloses the transaction in a timely manner. The acknowledgment can be a copy of the Form 8886, *Reportable Transaction Disclosure Statement* (or successor form), filed (or to be filed) by the Insured and must be received by the Owner prior to the time set forth in § 1.6011-4(e) in which the Owner would otherwise be required to provide disclosure.

(f) *Disclosure requirements.* Participants must provide the information required under § 1.6011-4(d) and the Instructions to Form 8886 (or successor form). For all participants, describing the transaction in sufficient detail includes, but is not limited to, describing on Form 8886 (or successor form) when, how, and from whom the participant became aware of the transaction, and how the participant participated in the transaction (for example, as an Insured, a Captive, or other participant). A Captive and an Insured must also provide the information required in § 1.6011-10(f)(2) and (3), respectively.

(g) *Applicability date*—

(1) *In general.* This section identifies transactions that are the same as, or substantially similar to, the transaction described in paragraph (a) of this section as transactions of interest for purposes of § 1.6011-4(b)(6) effective the date the regulations are published as final regulations in the **Federal Register.**

(2) *Obligations of participants with respect to prior periods.* Pursuant to § 1.6011-4(d) and (e), taxpayers who have filed a tax return (including an amended return) reflecting their participation in transactions described in paragraph (a) of this section prior to the date the regulations are published as final regulations in the **Federal Register,** who have not otherwise finalized a settlement agreement with the Internal Revenue Service with respect to the transaction, must disclose the transactions as required by §1.6011-4(d) and (e) provided that the period of limitations for assessment of tax (as determined under section 6501, including section 6501(c)) for any taxable year in which the taxpayer participated has not ended on or before the date the regulations are published as final regulations in the **Federal Register.** However, taxpayers who have filed a disclosure statement regarding their participation in the transaction with the Office of Tax Shelter Analysis pursuant to Notice 2016-66, 2016-47 I.R.B. 745, will be treated as having made the disclosure pursuant to the final regulations for the taxable years for which the taxpayer filed returns before the final regulations are published in the **Federal Register.** If a taxpayer described in the

preceding sentence participates in the Micro-captive Transaction of Interest in a taxable year for which the taxpayer files a return on or after the date the final regulations are published in the **Federal Register,** the taxpayer must file a disclosure statement with the Office of Tax Shelter Analysis at the same time the taxpayer files their return for the first such taxable year.

(3) *Obligations of material advisors with respect to prior periods.* Material advisors defined in § 301.6111-3(b) of this chapter who have previously made a tax statement with respect to a transaction described in paragraph (a) of this section have disclosure and list maintenance obligations as described in §§ 301.6111-3 and 301.6112-1 of this chapter, respectively. Notwithstanding § 301.6111-3(b)(4)(i) and (iii) of this chapter, material advisors are required to disclose only if they have made a tax statement on or after the date six years before the date the regulations are published as final regulations in the **Federal Register.** Material advisors that are uncertain whether the transaction they are required to disclose should be reported under this section or § 1.6011-10 should disclose under § 1.6011-10, and will not be required to disclose a second time if it is later determined that the transaction should have been disclosed under this section.

Douglas W. O'Donnell,

Deputy Commissioner for Services and Enforcement.

[FR Doc. 2023-07315 Filed 4-10-23; 8:45 am]

BILLING CODE 4830-01-P