

IR-2020-226, October 1, 2020

WASHINGTON — With the October 15 filing deadline quickly approaching, the Internal Revenue Service today encouraged taxpayers to consult an independent tax advisor if they participated in a micro-captive insurance transaction.

The IRS encourages any taxpayer who has continued to engage in an abusive micro-captive insurance transaction to not anticipate being able to settle its transaction with the IRS or Chief Counsel on terms more favorable than previously announced settlement offers and that any potential future settlement initiative that the IRS may consider will require additional concessions by the taxpayer.

With this in mind, the IRS encourages taxpayers to consult an independent tax advisor if they participated in a micro-captive insurance transaction. These taxpayers should seriously consider exiting the transaction and not claiming deductions associated with abusive micro-captive insurance transactions, just like many other taxpayers did who were contacted by the IRS in March and July 2020.

For those taxpayers that do not exit the transaction and continue taking such deductions, the IRS will disallow tax benefits from transactions that are determined to be abusive and may also require domestic captives to include premium payments in income and assert a withholding liability related to foreign captives. The IRS will also assert penalties, as appropriate, including the strict liability penalty that applies to transactions that lack economic substance under sections 7701(o) and 6662(i). The IRS Office of Chief Counsel will continue to litigate these abusive transactions in Tax Court.

"The IRS enforcement efforts will continue on these abusive transactions," IRS Commissioner Chuck Rettig said. "Any future settlement terms will only get worse, not better. The IRS has never been better positioned in its quest to eradicate abusive transactions following the stand-up of a dedicated promoter office, a new Fraud Enforcement Office, enhanced service-wide coordination with Criminal Investigation and the Office of Professional Responsibility, and our advanced data analytics and mining capabilities. Taxpayers are strongly encouraged to use this opportunity to put this behind them and get into compliance."

Abusive micro-captives have been a concern to the IRS for several years. The transactions first appeared on the IRS "Dirty Dozen" list of tax scams in 2014 and remain a priority enforcement issue for the IRS. In 2016, the Department of Treasury and IRS issued Notice 2016-66 PDF, which identified certain micro-captive transactions as having the potential for tax avoidance and evasion. In March and July 2020, IRS issued letters to taxpayers who participated in a Notice 2016-66 transaction alerting them that IRS enforcement activity in this area will be expanding significantly and providing them with the opportunity to tell the IRS if they've discontinued their participation in this transaction before the IRS initiates examinations. Early responses indicate that a significant number of taxpayers who participated in these transactions have exited the transaction.

This summer, the IRS issued a new round of section 6112 letters to material advisors who filed with the IRS pursuant to Notice 2016-66. In addition, the IRS has deployed 12 newly formed micro-captive examination teams to substantially increase the examinations of ongoing abusive micro-captive insurance transactions.

Also, as part of IRS's continued focus in this area, the IRS has become aware of variations of the abusive micro-captive insurance transactions. Examples of these variations include certain Puerto Rico and offshore captive insurance arrangements that do not involve section 831(b) elections.

These variations appear to be designed and marketed with the express intent of avoiding reporting under Notice 2016-66 and yet perpetuating in some cases the same or similar abusive elements as abusive micro-captive insurance transactions. The IRS is aware of these abusive transactions and is actively working to counter their proliferation. The IRS cautions taxpayers that, to the extent they engage in variations of abusive micro-captive transactions that are substantially similar to Notice 2016-66, they must be disclosed. Otherwise, the IRS will impose penalties for the failure to disclose.