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WASHINGTON — Internal Revenue Service officials today urged participants in abusive micro-captive insurance arrangements to exit these transactions as soon as possible. The IRS has stepped up examinations of these arrangements and has recently won yet another case in U.S. Tax Court that such arrangements are not eligible for the tax benefits claimed.

On March 10, 2021, the U.S. Tax Court held in *Caylor Land & Dev. v. Commissioner*, T.C. Memo. 2021-30 (2021), that yet another micro-captive arrangement failed to qualify as insurance for federal tax purposes. This decision follows several earlier Tax Court decisions that also confirmed the IRS's determinations that certain micro-captive arrangements were not eligible for the claimed federal tax benefits. In *Caylor*, the Tax Court also sustained the IRS's determination of accuracy-related penalties and rejected the taxpayer's claim of reliance on tax advice.

Taxpayers who engaged in abusive micro-captive transactions are once again encouraged to consult an independent tax advisor prior to filing their 2020 tax returns. Taxpayers should consider exiting the transaction and not reporting deductions associated with abusive micro-captive insurance transactions.

"In multiple cases before the courts, judges have held that these 'fanciful' and 'unreasonable' arrangements don't add up to insurance in the commonly accepted sense," said IRS Commissioner Chuck Rettig. "I strongly urge participants in these arrangements to get independent legal advice separate from those who helped steer them into these abusive arrangements."

In the past several years, the IRS has ratcheted up its efforts to combat abusive micro-captive insurance arrangements. In 2020, the IRS deployed 12 newly formed micro-captive examination teams to substantially increase the examinations of ongoing abusive micro-captive insurance transactions. 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 on foreign captives. The IRS will continue to assert penalties, as appropriate, including the strict liability penalty that applies to transactions that lack economic substance.

In Notice 2016-66, the IRS advised that micro-captive insurance transactions have the potential for tax avoidance or evasion. The notice designated transactions that are the same as or substantially similar to transactions that are described in the notice as "Transactions of Interest." The notice established reporting requirements for those entering into such transactions on or after Nov. 2, 2006 and created disclosure and list maintenance obligations for material advisors.

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.