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**The really juicy stuff is in the attachments to this Announcement, which are in the following pages.**

## **IRS offers settlement for micro-captive insurance schemes; letters being mailed to groups under audit**

IR-2019-157

WASHINGTON — The Internal Revenue Service announced today the mailing of a time-limited settlement offer for certain taxpayers under audit who participated in abusive micro-captive insurance transactions.

Taxpayers eligible for this offer will be notified by letter with the applicable terms. Taxpayers who do not receive such a letter are not eligible for this resolution.

Abusive micro-captives have been a concern to the IRS for several years. The transactions have appeared on the IRS "[Dirty Dozen](#)" list of tax scams since 2014. In 2016, the Department of Treasury and IRS issued [Notice 2016-66](#), which identified certain micro-captive transactions as having the potential for tax avoidance and evasion.

Following wins in three recent U.S. Tax Court cases, the IRS has decided to offer settlements to taxpayers currently under exam. In recent days, the IRS started sending notices to up to 200 taxpayers.

Tax law generally allows businesses to create "captive" insurance companies to protect against certain risks. Under section 831(b) of the Internal Revenue Code, certain small insurance companies can choose to pay tax only on their investment income. In abusive "micro-captive" structures, promoters, accountants or wealth planners persuade owners of closely held entities to participate in schemes that lack many of the attributes of genuine insurance.

The IRS has consistently disallowed the tax benefits claimed by taxpayers in abusive micro-captive structures. Although some taxpayers have challenged the IRS position in court, none have been successful. To the contrary, the Tax Court has now sustained the IRS' disallowance of the claimed tax benefits in three different cases.

The IRS will continue to disallow the tax benefits claimed in these abusive transactions and will continue to defend its position in court. The IRS has decided, however, to offer to resolve certain of these cases on the terms outlined below.

"The IRS is taking this step in the interests of sound tax administration," IRS Commissioner Chuck Rettig said. "We encourage taxpayers under exam and their advisors to take a realistic look at their matter and carefully review the settlement offer, which we believe is the best

option for them given recent court cases. We will continue to vigorously pursue these and other similar abusive transactions going forward.”

The settlement brings finality to taxpayers with respect to the micro-captive insurance issues. The settlement requires substantial concession of the income tax benefits claimed by the taxpayer together with appropriate penalties (unless the taxpayer can demonstrate good faith, reasonable reliance). Taxpayers eligible for the settlement will be notified of the terms by letter from IRS. The initiative is currently limited to taxpayers with at least one open year under exam. Taxpayers who also have unresolved years under the jurisdiction of the IRS Appeals may also be eligible, but those with pending docketed years under Counsel’s jurisdiction are not eligible. The IRS is continuing to assess whether the settlement offer should be expanded to others.

Taxpayers who receive letters under this settlement offer, but who opt not to participate, will continue to be audited by the IRS under its normal procedures. Potential outcomes may include full disallowance of captive insurance deductions, inclusion of income by the captive, and imposition of all applicable penalties.

Although taxpayers who decline to participate will have full Appeals rights, the IRS Independent Office of Appeals is aware of this resolution initiative. Given the current state of the law, it is the view of the IRS Independent Office of Appeals that these terms generally reflect the hazards of litigation faced by taxpayers, and taxpayers should not expect to receive better terms in Appeals than those offered under this initiative.

Taxpayers who are offered this private resolution and decline to participate will not be eligible for any potential future settlement initiatives. The IRS also plans to continue to open additional exams in this area as part of ongoing work to combat these abusive transactions.

ATTACHMENT 1  
Micro-Captive Insurance Resolution Terms

Below are the terms of the Micro-Captive Insurance resolution. The Internal Revenue Service (IRS) will not entertain counteroffers to these terms. If the Taxpayers do not agree with the terms, the Taxpayers' examination will continue under normal IRS procedures.

Section 1: General Terms and Conditions:

- a. Taxpayers must notify the IRS, in writing, of their election to participate in the resolution within 30 days of the date of this letter.
- b. Taxpayers may request a one-time 30-day extension to elect to participate in the resolution. No additional extension will be permitted.
- c. Each partner, member, and shareholder of each insured entity and the captive must agree to participate in the resolution.
- d. To finalize the resolution, Taxpayers will be required to execute a Form 906, *Closing Agreement on Final Determination Covering Specific Matters* (Closing Agreement), consistent with terms and conditions outlined in this document.
- e. Taxpayers will also be required to execute Form 8821, *Tax Information Authorization*, to facilitate the resolution.
- f. Taxpayers must pay the full balance of the deficiency, any applicable penalties and interest upon execution of the Closing Agreement. Taxpayers participating in the resolution are not entitled to interest suspension under I.R.C. § 6404(g).
- g. Any Taxpayer unable to make full payment of the liabilities described in Section 2. must submit complete financial statements and agree to financial arrangements acceptable to the IRS before the IRS will execute a Closing Agreement. The IRS will not execute a Closing Agreement under this resolution with Taxpayers unable to reach acceptable financial arrangements.
- h. Taxpayers with less than one year remaining on their assessment statute of limitation must sign a Form 872, *Consent to Extend the Time to Assess Tax*, and agree to extend the statute of limitation by at least one year.
- i. To facilitate the resolution, Taxpayers with years in Examination and Appeals must agree to ex parte waiver allowing Appeals employees to communicate with employees of other IRS functions without Taxpayers or Taxpayers' representative present.
- j. Taxpayers agree to fully cooperate with the IRS during the resolution, which includes, but is not limited to, providing additional information if requested by the IRS.
- k. Taxpayers agree that acceptance of this resolution indicates they are not entitled to claim or receive tax benefits arising from the captive insurance transaction, except as described in this Attachment 1.

Section 2. Financial Terms:

- a. Ninety percent (90%) of any deductions claimed for captive insurance premiums will be disallowed for all open tax years; the remaining 10% will be allowed for all open tax years.

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Insured Initials

- b. Any captive-related expenses claimed on the insured's return(s), including, but not limited to, fees paid to captive managers for formation or maintenance of a captive, will be disallowed in full.
- c. The captive will not be required to recognize taxable income for received premiums.
- d. The captive (1) must have already liquidated (2) will be required to liquidate or (3) will recognize income for a deemed qualified dividend and adjust basis for deemed capital contributions as described in the Appendix.
- e. An accuracy-related penalty under I.R.C. § 6662(a) will be asserted at a reduced rate of 10%.
  - i. The penalty will be reduced by 5% for Taxpayers that have not previously participated in any other reportable transaction. Taxpayers must sign the declaration provided.
  - ii. The penalty will be reduced by 5% for Taxpayers that relied on advice from an independent tax professional. The independent tax professional must sign the declaration provided.
  - iii. Taxpayers that submit valid reportable transaction and independent advisor declarations will have the accuracy-related penalty under I.R.C. § 6662(a) reduced to 0%.
- f. Taxpayers must file gift tax returns and pay gift tax, absorb credit, or both for any transfer of value to the shareholders of the captive.
- g. If none of the parties to the micro-captive transaction disclosed the transaction as required by Notice 2016-66, as modified by Notice 2017-08, one penalty under I.R.C. § 6707A, Penalty for Failure to Include Reportable Transaction Information with Return, will be applied at the rate applicable to natural persons under I.R.C. § 6707A(b)(3) (i.e., \$5,000). Taxpayers will not seek rescission of the penalty under I.R.C. § 6707A(d).
- h. Additions to tax for failure to file or pay tax under I.R.C. § 6651 and failure to pay estimated income tax under I.R.C. §§ 6654 and 6655 may apply. No other penalty will be imposed.

To participate in this resolution, please initial page 1 and sign and date page 2 of this Attachment 1, and mail this Attachment 1 to the IRS listed contact referenced in the cover letter. Your signature will be considered a non-binding consent to participate in this resolution; formal agreement to be memorialized subsequently with a Closing Agreement, as described above. By signing this Attachment 1, the person named below certifies that he/she has legal authority to execute this election on behalf of the insured. In addition, by signing this form, Taxpayer(s) waive their right to participate in discussions between IRS Appeals and personnel from other IRS functions, such as Examination or Counsel, that may take place in connection with the micro-captive insurance resolution.

\_\_\_\_\_  
Print Name and Title

\_\_\_\_\_  
Insured Name

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

## APPENDIX

- a. The captive's shareholders will each be required to recognize income for a deemed qualified dividend and adjust basis for deemed capital contributions in the year of the captive's last filed income tax return. Each deemed qualified dividend and deemed capital contribution will be pro rata with respect to all shares of the captive's stock.
  - i. In accordance with its ownership interest in the captive, each captive shareholder will include in income a deemed qualified dividend equal to its proportional share of:
    - a. All captive insurance premium deductions allowed to the insureds (that is, all of the insurance premium deductions for closed tax years plus 10% of the insurance premium deductions for open tax years);
    - b. Less, expenses paid by the captive to parties other than the captive manager or any affiliate of the captive manager that were not previously deducted (such as premium taxes, bank fees, return preparation fees);
    - c. Less, insurance claims paid by the captive; and
    - d. Less, taxable distributions previously made to the captive's shareholders;
  - ii. Provided, however, that no adjustment to any captive shareholder's income will be made if the amount determined under subparagraph i. is less than zero.
  - iii. At the time of the deemed qualified dividends, the captive's earnings and profits will be deemed to be at least equal to the amount of the total deemed qualified dividends for all the shareholders.
  - iv. Immediately following the deemed qualified dividends, the captive's shareholders will each be deemed to make a capital contribution to the captive in the amount of the deemed dividend described above.
  - v. Immediately following the deemed capital contributions described in subparagraph iv., each of the captive's shareholders, in accordance with its ownership interest in the captive, will be deemed to make another capital contribution to the captive equal to its proportional share of the amount of the captive insurance premiums disallowed as deductions (that is, 90% of the insurance premium deductions for open tax years) to an insured entity that is not taxed as a C corporation for Federal income tax purposes.
- b. If the captive made an election under § 953(d), after the deemed capital contribution in subparagraph (v), the § 953(d) election will be terminated and the principles of § 953(d)(5) and the regulations thereunder will apply such that all property held by the captive will be deemed transferred to a foreign corporation in an exchange to which § 367 applies in the year of the captive's last filed income tax return. However, if the captive engages in an "inbound F reorganization" to become a U.S. corporation (including a domestic eligible entity that elects to be taxed as a corporation), the step transaction doctrine will apply to treat the combination of the deemed exchange pursuant to § 953(d)(5) and the inbound F reorganization as an F reorganization where a U.S. corporation converts into another U.S. corporation (including a domestic eligible entity that elects to be taxed as a corporation).
- c. The captive's § 831(b) election will be terminated.
- d. If captive has more than one class of stock or has recently participated in a reorganization, special provisions may apply.