

Alert | Tax Audits, Litigation & Criminal Tax Defense



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Second Round of Micro-Captive Insurance Settlements Provides Stricter Terms

On Oct. 22, 2020, **the IRS announced** it is offering a second time-limited settlement initiative to certain taxpayers who participated in abusive micro-captive insurance transactions and who currently are under audit. This second round of settlement offers, to be mailed in the coming days, has stricter settlement terms than the IRS's **first time-limited initiative**. This increase in enforcement is occurring after the IRS deployed 12 newly formed micro-captive examination teams to increase the examination of micro-captive insurance transactions.

IRS Settlement Offer

Under the terms of the new settlement offer, the IRS will require substantial concessions of the income tax benefits claimed by the taxpayer, together with penalties. These penalties can be partly mitigated if the taxpayer can demonstrate good faith, reasonable reliance on an independent, competent tax advisor, and that it did not participate in any other reportable transactions. The settlement initiative comes after the **IRS warned taxpayers** that any future settlement initiative would require additional concessions.

This second time-limited settlement initiative is limited to taxpayers with at least one open year under examination, or those with unresolved years under the jurisdiction of the IRS Independent Office of Appeals. However, tax years involving micro-captive transactions docketed in Tax Court under IRS counsel's jurisdiction, in general, are not eligible. Certain taxpayers who rejected the first time-limited

settlement initiative may receive an offer under this second time-limited settlement initiative, but under the new, stricter terms.

Previous IRS Enforcement

Terms of the previous settlement initiative were not publicized, although substantial taxes and appropriate penalties were expected, unless the taxpayer could establish reasonable cause to avoid the penalties.

On March 20, 2020, [the IRS sent Letter 6336](#) to certain micro-captive taxpayers, requiring such taxpayers to advise the IRS if they are no longer claiming deductions or other tax benefits for covered micro-captive insurance transactions.

Following several IRS victories in the U.S. Tax Court, the IRS previously decided to offer settlements to taxpayers currently under examination and mailed settlement letters to taxpayers. These settlement initiatives are not unexpected given the IRS's recent victories and the flood of docketed cases in the Tax Court on this issue. A settlement initiative such as this one represents an effort to deal with the volume of cases. The initiative should resolve more cases without litigation and produce finality for those accepting the fixed settlement terms.

The second time-limited settlement offer will terminate after a certain amount of time (unspecified in the Oct. 22 notice). The IRS may expand this program to make additional settlement offers. Taxpayers who receive offer letters under this settlement initiative, but who opt not to participate, will continue to be audited by the IRS under its normal procedures. Potential outcomes include a full disallowance of captive insurance deductions, inclusion of income by the captive, withholding tax related to any foreign captives, and imposition of all applicable penalties.

Although taxpayers who decline to participate in the settlement will have full appeals rights, the IRS Independent Office of Appeals is aware of this settlement initiative. The IRS announcement states that taxpayers should not anticipate receiving better terms in Appeals than those offered under this initiative.

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