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IRS to Increase Enforcement Against Abusive Micro-Captive Insurance Transactions

Emboldened by significant victories in three Tax Court cases involving micro-captive insurance companies,¹ on Jan. 31, 2020, the **IRS announced** that it is establishing 12 new examination teams to assist in the audits of abusive micro-captive insurance transactions. The IRS expects the audit teams to immediately begin new examinations that will impact several thousand taxpayers involved in micro-captive insurance transactions. The IRS also announced that it expects to hire an executive to coordinate and oversee promoter and material advisor investigations, which include micro-captive insurance transactions.

In September 2019, **the IRS sent settlement offers to approximately 200 taxpayers involved in micro-captive insurance audits.** Under the terms of the settlements, taxpayers were required to concede a substantial amount of the claimed income tax benefits from the transactions and agreed to be subject to reduced penalties. In the Jan. 31 announcement, the IRS touted that nearly 80% of taxpayers involved in micro-captive insurance audits accepted the settlement offers from the IRS. “The overwhelming acceptance rate of the private settlement offer is a reflection of the success the government’s work to stop this abuse,” said IRS Commissioner Chuck Rettig. Thus, the establishment of dedicated audit teams to

¹ *Avrahami v. Commissioner*, 149 TC 144 (2017); *Szyzygy Insurance Co., Inc. v. Commissioner*, T.C. Memo 2019-34; *Reserve Mechanical Corp. v. Commissioner*, T.C. Memo 2018-86.

curb the ongoing abuse by promoters and taxpayers of micro-captive insurance companies indicates that there are still many abusive micro-captive transactions that the IRS is pursuing.

Previous IRS Enforcement Actions

Abusive micro-captive insurance transactions have been on the IRS's radar for several years. They first appeared on the IRS's annual "Dirty Dozen" list of tax scams in 2014. Enforcement was stepped up in 2016 when the IRS issued Notice 2016-66 to help it identify abusive micro-captive insurance transactions. Under Notice 2016-66, taxpayers are required to disclose their participation in certain micro-captive insurance transactions to the IRS Office of Tax Shelter Analysis, and the failure to disclose participation in a micro-captive would subject participants to increased penalties. In 2017, the IRS's Large Business and International (LB&I) Division announced its examination campaign to address transactions described in Notice 2016-66, including micro-captive insurance transactions. According to IRS guidance issued in 2017, LB&I's campaign was to be conducted through issue-based examinations, which involved standardized Information Document Requests that asked lengthy and detailed questions about the transaction.

Beware

Armed with significant Tax Court wins and the settlement of 80% of micro-captive taxpayer cases under audit, the IRS now has declared that it intends to collect a significant amount of revenue lost because of abusive micro-captive insurance transactions. Nevertheless, advisors continue to actively promote micro-captives, which makes it crucial that taxpayers seek guidance on the characteristics of bona fide insurance for income tax purposes.

Anyone with questions regarding micro-captive insurance transactions and the increased enforcement actions by the IRS with respect to them should contact Greenberg Traurig's Audits, Litigation & Criminal Tax Defense Group for assistance.

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