ABA Tax Times

AMERICAN BAR ASSOCIATION
Tax Section

An Online Publication of the ABA Tax Section

Spring • June 2021 • Vol. 40 No. 3

AT COURT

Micro-Captive Insurance at the Tax Court

By **David Slenn**, Shumaker, Loop & Kendrick, LLP, Tampa, FL

Caylor Land & Dev., Inc. v. Comm'r of Internal Revenue[1] is the fourth Tax Court opinion involving a taxpayer's attempt to deduct premiums paid to, and excluded from the gross income of, a "micro-captive" insurance company. It is also the fourth straight IRS victory over such transactions. Although the Tax Court found the lack of insurance for federal tax purposes in all four cases, *Caylor* expanded the analytical framework used to determine whether a micro-captive program constitutes insurance. Unlike the three prior micro-captive cases, *Caylor* involved a variation of the micro-captive structure and was the first case resulting in successful assertion of penalties. Consequently, *Caylor* provides additional guidance for taxpayers and their advisers when engaging in a cost-benefit analysis for forming and defending micro-captives. The result in *Caylor* and existing guidance should lead advisers who play certain roles in implementing micro-captive arrangements or preparing tax returns reflecting micro-captive tax benefits to carefully consider their next steps.

What Is a Micro-Captive and Why Is It Subject to Intense Scrutiny?

Briefly, a captive insurance company is an insurance company that writes insurance policies for its owners and affiliates. Amounts paid to third parties for insurance policies are deductible, but amounts set aside as a form of self-insurance are not.[2] A "micro-captive" insurance company is a captive insurance company that makes a section 831(b) election to be taxed only on its investment income and not on its underwriting income, which must be less than $2.2 million per year.[3] As a tradeoff for this election, the captive insurer may not deduct its underwriting losses.[4]

A major issue for captive insurance companies is whether the captive program sufficiently resembles traditional insurance so that premiums can be deducted, or whether it lacks such features and is merely non-deductible self-insurance. In order to deduct insurance premiums paid to a captive insurance program, three requirements must generally be satisfied: (i) insurance risk must be shifted from the insured to the

[1] Caylor Land & Dev., Inc. v. Comm'r of Internal Revenue, T.C. Memo. 2021-30 (2021).

[2] *See* Harper Grp. & Includible Subsidiaries v. Comm'r, 96 T.C. 45, 60 (1991), aff'd sub nom. Harper Grp. v. Comm'r, 979 F.2d 1341 (9th Cir. 1992) (concluding "that for Federal income tax purposes the payments by Harper's domestic subsidiaries to Rampart were in form, as well as in substance, insurance payments. Such payments were not the equivalent of a self-insurance reserve. Accordingly, they are deductible.").

[3] Note that for the years at issue in *Caylor*, the premium limit under the section 831(b) election was $1.2 million.

[4] § 831(b)(1)-(2).

Published in *ABA Tax Times*, June 2021. © 2021 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association. ISSN 2381-5868.

insurer, (ii) the insurance risk must be sufficiently distributed, and (iii) the program must reflect insurance in its commonly accepted sense.[5]

Needless to say, the line between non-deductible self-insurance and deductible captive insurance has not been the brightest.[6] The IRS has litigated this issue for decades, with the last several taxpayer victories involving large corporate insureds.[7] The section 831(b) election created a major attraction for a boon to owners whereby smaller businesses could deduct relatively large amounts of premiums at ordinary income tax rates, to eventually be distributed to the owners or affiliates at capital gain rates. If claims were not paid, the premiums could be distributed from the captive to a completed gift trust and totally sidestep transfer taxes in the process. In addition to the income tax arbitrage and transfer tax benefits, the captive was also marketed as an "asset protection" vehicle where premiums paid to the captive were assumed to be "reasonably equivalent value" for fraudulent transfer purposes, thus cleansing the funds from further attack up the ownership chain.[8] Like all cutting-edge techniques, the micro-captive transaction became mainstream and drew national attention for its tax abuse potential in 2015.[9]

IRS Enforcement

By 2015, the general public found micro-captives listed alongside other forms of abusive tax transactions in the IRS' annual Dirty Dozen listing.[10] More recently, some micro-captive industry proponents have focused on the capability of micro-captives to provide much needed relief for business owners suffering losses due to COVID-related business interruption.[11] This media attention, along with lobbying efforts[12] and state-sanctioned use, has created an environment where it has become difficult for taxpayers to distinguish between healthy micro-captives and others the IRS views as infected with an abusive tax "virus."

Today, the IRS is in the midst of managing the spread of this abusive tax virus. The initial growth was no doubt accelerated by the formation of numerous management companies promoting the proliferation of abusive and non-abusive micro-captive transactions. Certain regulatory departments, domestic and foreign, both accommodated and welcomed the surge in development through lower capital requirements, premium taxes and other fees.

---

[5] Helvering v. Le Gierse, 312 U.S. 531 (1941). The Supreme Court had to determine whether the insurance proceeds were "insurance" proceeds for federal tax purposes such that they would be excludable from a decedent's estate. It held the combination of an annuity with life insurance negated the insurance aspect of the transaction.

> "The two contracts must be considered together. To say they are distinct transactions is to ignore actuality, for it is conceded on all sides and was found as a fact by the Board of Tax Appeals that the 'insurance' policy would not have been issued without the annuity contract. Failure, even studious failure, in one contract to refer to the other cannot be controlling. Moreover, authority for such consideration is not wanting, however unrealistic the distinction between form and substance may be." *Id.* at 540-41.

[6] *Harper*, 96 T.C. at 46 (noting that "[c]aptive insurance transactions, such as the one before us, straddle the fence between ordinary insurance and self-insurance").

[7] *See* Rent-A-Center, Inc. v. Commissioner, 142 T.C. 1 (2014); Securitas Holdings, Inc. v. Commissioner, T.C. Memo. 2014-225 (2014); and R.V.I. Guar. Co. v. Commissioner, 145 T.C. 209 (2015).

[8] This approach ignores a number of creditor arguments, including whether reasonably equivalent value was actually given pursuant to a claim for relief under constructive intent, a claim for relief under actual intent, the application of substance over form under the fraudulent transfer common law and alter ego.

[9] *See* *I.R.S. Is Looking Into Captive Insurance Shelters*, The N.Y. Times (Apr 10, 2015).

[10] *See* IR 2015-19, Feb. 3, 2015.

[11] *See* *Once Scrutinized, an Insurance Product Becomes a Crisis Lifeline*, The N.Y. Times (Mar 20, 2020).

[12] *See* Eli Flesch, *Senator Seeks Suspension Of Captive Insurer Review,* Law360 Tax Authority (Sept 1, 2020) (noting that Republican Senator Cory Gardner of Colorado "is seeking to suspend an Internal Revenue Service review of tax benefits claimed by microcaptive insurance companies, said a letter released Tuesday by the U.S. Treasury").

Published in *ABA Tax Times*, June 2021. © 2021 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association. ISSN 2381-5868.

A proposed amendment to section 831(b) in early 2015 would have most likely eradicated many micro-captive programs; however, modifications resulted in a watered-down version that ultimately amounted to little more than a short pause in the growth of abusive micro-captives. It was not until the fall of 2016 when the IRS developed its first "vaccine" to counter the abusive micro-captive virus by issuing Notice 2016-66, making certain micro-captive transactions a "transaction of interest."[13] Notice 2016-66 required micro-captive participants who satisfied certain guidelines to file Form 8886 with the Office of Tax Shelter Analysis and with their annual income tax returns.

Together with a growing list of favorable results in U.S. Tax Court beginning in 2017 with *Avrahami v. Commissioner*,[14] and administration of micro-captive campaign "treatment streams" which include ongoing public outreach and sending "soft letters" to participants identified on Form 8886[15], the IRS has progressed in slowing the spread of abusive micro-captive transactions.[16] With *Caylor*, the IRS builds upon its decisional law foundation as it continues its aggressive campaign against abusive micro-captives and their variants.

The Caylor Case

Caylor Construction and Its Related Entities

The Caylor family ran a number of businesses, starting with Caylor Construction in 1958. Caylor Construction was a commercial construction company with expertise as a general building contractor. Bob Caylor was a successful businessman and known in the industry as a "steady leader and avoided overextending in good times."[17] The family business grew and resulted in ten subsidiaries and affiliated companies, though Caylor Construction generated most of the revenue, with the success of the Caylor affiliates following the fortunes of Caylor Construction. This was because the vast majority of revenue for each Caylor entity was comprised of consulting fees paid by Caylor Construction.

Insurance Needs and Introduction to Captive Insurance

For nearly thirty years, Caylor Construction bought commercial insurance to serve its insurance needs, with commercial premiums fluctuating between roughly $50,000 to $70,000 per year. Although the coverages were broad, they did not cover every single loss Caylor experienced: in a ten year period, the Caylor entities had $500,000 of losses not covered by the commercial program, or about $50,000 per year.

[13] *See* CIC Servs., LLC v. Internal Revenue Serv., No. 19-930, 2021 WL 1951782 (U.S. May 17, 2021). CIC Services, LLC filed a lawsuit against the IRS challenging the constitutionality of Notice 2016-66. The IRS prevailed in both the District Court for the Eastern District of Tennessee and the Sixth Circuit Court of Appeals. Ruling in favor of CIC Services on May 17, the Supreme Court found that the Anti-Injunction Act did not bar CIC's lawsuit seeking to enjoin Notice 2016-66.

[14] Avrahami v. Commissioner, 149 T.C. 144 (2017) (deduction for premiums denied without penalties); Rsrv. Mech. Corp. v. Comm'r of Internal Revenue, T.C. Memo. 2018-86 (2018) (withholding tax due for payments to captive; IRS did not seek penalties); and Syzygy Ins. Co. v. Comm'r of Internal Revenue, T.C. Memo. 2019-34 (2019) (deduction for premiums denied with premiums considered income to the captive; no penalties).

[15] For more on Letter 6336, see "Implications of the Micro-Captive Soft Letter," May 1, 2020, American Bar Association, Business Law Section, available at: https://businesslawtoday.org/2020/05/implications-micro-captive-soft-letter/.

[16] *See* IR-2021-82, April 9, 2021. ("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."); IR-2020-26, January 31, 2020. ("The overwhelming acceptance rate of the private settlement offer is a reflection of the success of the government's work to stop this abuse," said IRS Commissioner Chuck Rettig. "Taxpayers who elected to accept the IRS' terms have done the right thing by coming into compliance with their federal tax obligations and putting this behind them. Putting an end to abusive schemes is a high priority for the IRS.")

[17] *Caylor* at 4.

Published in *ABA Tax Times*, June 2021. © 2021 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association. ISSN 2381-5868.

In 2007, Rob (Bob Caylor's son) and Rob's accountant attended a captive insurance lunch presentation at a country club. The presenter, Tribeca, covered the basics of captive insurance and stressed microcaptives along with their potential tax benefits. Although Rob was convinced captives would be beneficial, the accountant was less convinced. The accountant informed Rob that captives were outside his expertise, but he offered to conduct an internet search on captives and check with the State Board of Accountancy to see whether any complaints were filed against Tribeca. The accountant concluded that if captives were done right, they had potential to work. He also concluded, however, that he could not determine whether Tribeca's specific program would work for federal tax purposes.

Rob also asked his longtime tax and business attorney to look into captive insurance. Similar to the accountant, the lawyer admitted he was not an expert in the area but concluded that captive insurance was legitimate if done correctly. The court noted that although Rob conferred with his accountant and tax and business attorney, he did not confer with his long-time insurance adviser as to whether the captive program would supplement their existing commercial program.

The Caylor Micro-captive Structure

Ultimately, the Caylors formed a captive insurance company named Consolidated, Inc., under the laws of Anguilla. Consolidated would make a section 953(d) election to be treated as a domestic insurance company as well as elect to be taxed under section 831(b) to become a "micro-captive." The captive structure featured 12 Caylor entities all paying premiums that amounted to nearly $1.2 million.

Caylor's Risk Distribution

Briefly, a captive can provide risk distribution either by insuring a sufficient number of its related party risks or by insuring a certain amount of unrelated party risks. Unlike the captive programs in *Avrahami*, *Reserve Mechanical* and *Syzygy* that involved unrelated risks, Consolidated attempted to generate risk distribution by insuring only its related parties—i.e., the 12 Caylor entities.[18] With this approach, the Caylors likely hoped that their fact pattern resembled the large corporate taxpayers who had prevailed in more recent Tax Court victories—e.g., *R.V.I.*, *Securitas* and *Rent-A-Center*.

The Caylors argued on three separate grounds that they had indeed accomplished risk distribution: (1) Consolidated insured a number of unrelated risks sufficient to permit the law of large numbers to predict expected losses; (2) there were at least 12 related insureds, and none of the insureds had coverage of less than 5% nor more than 15% of the total risk; or (3) at least 30% of Consolidated's risk assumed were from unrelated parties.

Judge Holmes found Consolidated did not meet any of these three tests. The third test did not apply since all of Consolidated's risk was assumed from related parties. The second test was not met because the vast majority of risk was assumed from Caylor Construction and another related entity (with a combined risk of at least 60% between those two entities.) Finally, the law of large numbers did not apply. Judge Holmes emphasized that the phrase large numbers truly means "large" numbers.

> But this is called the law of large numbers—not small numbers or some numbers. Our caselaw demonstrates how very large these numbers *must* be. In Harper Group, the captive

[18] *See* Rev. Rul. 2002-90, 2002-2 C.B. 985 (2002) (noting that "S charges the 12 subsidiaries arms-length premiums, which are established according to customary industry rating formulas. None of the operating subsidiaries have liability coverage for less than 5%, nor more than 15%, of the total risk insured by S. S retains the risks that it insures from the 12 operating subsidiaries.").

Published in *ABA Tax Times*, June 2021. © 2021 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association. ISSN 2381-5868.

> insured 7,500 customers covering more than 30,000 different shipments and 6,722 special cargo policies. This meant more than 260,000 air shipments; 18,000 air flights; and 40,000 shipments on more than 3,000 ocean voyages were covered. In Rent-A-Center, the captive insured three types of risks—workers' compensation, automobile, and general liability. It insured 14,000 employees; 7,000 vehicles; and 2,600 stores. And in R.V.I. Guaranty, the insurance company insured one type of risk, the residual value of assets. But even there, the insurance company issued 951 policies covering 714 different insured parties with more than 754,000 passenger vehicles; more than 2,000 individual real-estate properties; and more than 1.3 million commercial-equipment assets.[19]

In finding Caylor's independent risks insufficient, Judge Holmes determined the independent exposures were based on the number of policies purchased by each entity (i.e., there were at most 12 independent exposures for two coverages, 11 independent exposures for another coverage, 10 independent exposures for another coverage, etc.) In other words,, the number of exposures were nowhere near what qualified in the three large captive cases. Judge Holmes also determined the risks weren't independent, as Caylor Construction had the vast majority of revenue and premiums were calculated based on revenue. Even if revenue was not the only measure of risk, revenue was used to determine premiums, which suggested that revenue was an indicator of risk that Consolidated insured. Further, the Caylor entities were highly dependent upon the success of Caylor Construction as they received all or most of their revenue from Caylor Construction. Nor was there geographic diversity among the entities since they were all located in Tucson. Without risk distribution, the Court concluded Consolidated was not providing insurance.

Insurance in the Commonly Accepted Sense

Although the absence of risk distribution was fatal, the Court went on to examine whether Consolidated sold an arrangement that looked like insurance. For this analysis the Court examined Consolidated's (i) organization, operation and regulation, (ii) capitalization, (iii) insurance policies (must be valid and binding) and (iv) premiums (must be reasonable). Although Consolidated was organized as an insurance company, the court found it did not operate like an insurance company. The premium pricing and claims payment process was abnormal. Consolidated met the minimum capitalization requirements. As to whether the insurance policies were valid and binding, the court took exception with the fact that the policies were not issued until *after* the claims periods ended.

The court also had problems on a macro and micro level with the premiums charged. On the macro issue, the court noted that the Caylor entities paid approximately $50,000 per year over a 10-year period for losses not covered by commercial insurance, whereas the Caylors adopted a captive program that charged roughly $1.2 million per year in premiums. On a micro level, the court found adjustments made to base rates were unreasonable.

> The calculations of the premiums also made little sense. Gotzinger, in calculating the premiums, started in a normal place—the ISO (Insurance Services Office) base rate. But the calculations soon took a detour to crazy town. Several adjustments were made to these base rates which had the effect of raising the premiums for each policy—which makes sense only as an effort to increase the total premium to the desired $1.2 million.[20]

[19] Caylor Land & Dev., Inc. v. Comm'r of Internal Revenue, T.C.M. (RIA) 2021-030 (T.C. 2021) (citations omitted and emphasis added).
[20] *Caylor*, T.C.M. 2021-030, at 15.

Published in *ABA Tax Times*, June 2021. © 2021 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association. ISSN 2381-5868.

Finally, the court examined the payment of claims, which it suspected would be odd given everything else surrounding the policies.[21] The court pointed to an example where a claim was filed, but no supporting documentation was produced pursuant to a Tribeca request. Nonetheless, the claim was paid.

> The first claim in 2009 was for $13,000 in legal fees that Caylor Construction incurred to collect a debt. Tribeca requested additional support for the claim—such as an invoice or proof of payment—but none was ever submitted. Instead Rob and Paula in their capacities as Consolidated's owners overruled the captive managers at Tribeca and ordered that the claim be paid. Consolidated issued a $13,000 check.[22]

Ultimately, the list of issues was too much for the Caylors to overcome.

> Because we find that Consolidated failed to distribute risk and was not selling insurance in the commonly accepted sense, we need not decide whether its transactions involved insurance risk or risk shifting. Despite the attempts of Consolidated to make its transactions look like traditional insurance and take advantage of the apparent loophole at the intersection of section 831 and captive-insurance caselaw, the premiums paid to Consolidated and deducted by the Caylor entities are not "insurance" for federal tax purposes. As in Avrahami, as in Syzygy, and as in Reserve, we find that the microcaptive didn't actually provide insurance because it failed to distribute risk and didn't act as an insurer commonly would.[23]

Not only were the deductions denied, but the Court upheld 20% accuracy-related penalties for substantial understatement and negligence.[24] Although the Caylors involved an accountant and lawyer in their captive planning, these advisers were not familiar with captive insurance and did not provide advice as to the particular micro-captive transaction. Thus, the Caylors did not have a reasonable cause defense.

Takeaways for Captive Insurance Tax Advisers

Advisers should consider whether *Caylor*'s result will impact decisions to amend tax returns before audit or settle with the IRS afterwards.[25] Until more guidance is established, it is likely that more controversies will arise that feature better facts and require closer calls.[26]

Advisers must keep reporting issues in mind, for both ongoing micro-captive programs and clients expressing an interest in captives. Just as a micro-captive program might not fit squarely within the facts of existing case law for income tax deduction purposes, the same may hold true for reportable transaction purposes. Many programs do not fit neatly within Notice 2016-66's transaction description, especially as variations develop. Advisers will need to determine whether a micro-captive variant is substantially similar to the

[21] "[I]nasmuch as these claims were made on claims-made policies that Consolidated didn't issue until after the policy years had closed, one might expect there to be something odd about them. One would be right." *Id.* at 8.

[22] *Id.*

[23] *Id.* at 16 (citations omitted).

[24] The Court noted stipulations that indicate the IRS did not comply with section 6751(b) in at least some of the docketed Caylor cases.

[25] Under the IRS micro-captive resolution initiative, the second tranche settlement offer provides for roughly the same settlement terms as the first tranche, other than the increase of penalties from a range of 0-10% to 5-15%, and the disallowance of any premium deduction. In *Caylor*, the Tax Court affirmed penalties of 20%; however, the IRS may also seek penalties for lack of economic substance (20%) and non-disclosure (40%), which are *strict liability* penalties.

[26] *See Caylor*, T.C.M. 2021-030, at 12 (indicating "no precise number of independent risks that must exist for risk to be sufficiently distributed to meet this element—we're not a legislature or regulator, and that's not the way common-law concepts become clearer over time").

Published in *ABA Tax Times*, June 2021. © 2021 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association. ISSN 2381-5868.

Notice 2016-66 transaction. One should look at the practical effect of a proposed variant and ask whether it accomplishes the same result as the reportable transaction.[27]

The IRS has already provided some indication that it is monitoring variants. For example, the IRS notified taxpayers of a Puerto Rican variant in a 2020 information release.[28] Additionally, the IRS released a 2021 Field Attorney Advice (FAA) regarding whether a particular captive insurance transaction was substantially similar to the transaction described in Notice 2016-66.[29] The FAA apparently involved a promoter's "routine micro-captive transactions."[30] This FAA provides helpful analysis involving the application of Notice 2016-66.

Advisers must also determine whether they are "material advisors" necessitating the filing of Form 8918. The IRS issued 6112 letters in the summer of 2020 to certain material advisors, requiring such advisors to file their required list information. Going forward, advisors must also determine whether they might become a material advisor with respect to clients who are interested in forming a captive insurance company. Such an engagement would necessarily require examining whether the advisor receives requisite fees[31] and "provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out" of a proposed micro-captive insurance program that is substantially similar to the transaction described in Notice 2016-66.[32]

Advisers who prepare tax returns must also consider whether they are subject to return preparer penalties. This will also require examining the strength of a micro-captive transaction reflected on a tax return. Section 6694 provides that if a tax preparer prepares any tax return with respect to which any part of an understatement of liability is due to an unreasonable position, the tax preparer shall pay a penalty with

[27] *See* Turnham v. Comm'r of Internal Revenue, 979 F.3d 1322 (11th Cir. 2020).

> These listed transactions "typically are invested in variable life or universal life insurance on the lives of the covered employees." 1995-1 C.B. 309. A universal life insurance policy is a quasi-insurance product in which the premiums partly fund death benefits and partly accumulate and earn interest to fund future benefits for the covered person. *See* Anderson v. Wilco Life Ins. Co., 943 F.3d 917, 920–21 (11th Cir. 2019). While the investment scheme here did not use universal life insurance products in the literal sense, there really isn't any difference in practical effect. The combination of a term life policy with a separate (and much larger) annuity product provided the same generous excess of funds that a universal life policy would itself provide. And, there is no dispute that a welfare plan using a universal life policy would likely not be exempt and the contributions thereto would likely not be fully deductible. … We find here, however, that as a matter of law the subject Plan is at a minimum "substantially similar" to the listed transaction in the IRS Notice, such that the Appellants were required to disclose their participation in it, as IRS regulations dictated. Because they failed to do so, the IRS properly issued the penalties against them. *Id.* at 1325–26.

[28] IR-2020-226, October 1, 2020.

> 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. *Id.*

[29] IRS Field Attorney Advice (FAA 20211701F) on Captive Insurance Promotion Notice 2016-66. The issue in FAA 20211701F was "[w]hether the captive insurance transactions promoted by [redacted data] are the same as, or substantially similar to, the "section 831(b) micro-captive transactions" identified as transactions of interest in I.R.S. Notice 2016-66."

[30] *Id.* (noting that "[b]ased upon our analysis of the 5 factors outlined in section 2.01 of Notice 2016-66, we conclude that the routine micro-captive insurance transactions promoted by [redacted data] are the same as, or substantially similar to, the TOI described in Notice 2016-66").

[31] § 6111(b)(1)(A)(ii); Treas. Reg. § 301.6111-3(b)(1).

[32] § 6111(b)(1)(A)(i); Treas. Reg. § 301.6111-3(b)(1).

Published in *ABA Tax Times*, June 2021. © 2021 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association. ISSN 2381-5868.

respect to each return in an amount equal to or greater than $1,000 or 50% of the income derived by the tax return preparer with respect to the return.[33] Notably, section 6694(a)(2)(C) provides that a reportable transaction is unreasonable unless it is "reasonable to believe that the position would more likely than not be sustained on its merits."

Finally, advisers should recall the IRS has formed 12 new audit teams to handle the exam workload.[34] During a recent ABA webinar, an IRS official mentioned having over 100 Chief Counsel attorneys trained on captive insurance.[35] The IRS also announced the creation of the Office of Promoter Investigations to coordinate efforts across multiple business divisions to address abusive syndicated conservation easements and abusive micro-captive insurance arrangements, as well as other transactions.[36] Ultimately, the exposure associated with a micro-captive insurance program is large enough to require advisers to give careful consideration to entering a micro-captive program or taking corrective measures immediately as to clients who are already in abusive micro-captive programs. ■

[33] § 6694(a)(1).

[34] IR-2020-26, January 31, 2020. ("In addition, the IRS is establishing 12 new examination teams that are expected to open audits related to thousands of taxpayers in coming months.")

[35] "A Practitioner's Guide to the IRS Micro-Captive Insurance Campaign," January 26, 2021. American Bar Association, Real Property Trust & Estate Law Section.

[36] IR-2021-88, April 19, 2021.

Published in *ABA Tax Times*, June 2021. © 2021 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association. ISSN 2381-5868.