IRS

Treasury and IRS propose regulations identifying micro-captive transactions as abusive tax transactions

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WASHINGTON — The Treasury Department and Internal Revenue Service today issued proposed regulations identifying certain micro-captive transactions as "listed transactions" and certain other micro-captive transactions as "transactions of interest."

Listed transactions are abusive tax transactions that must be reported to the IRS. Transactions of interest are tax transactions that have the potential for tax avoidance or evasion that must also be reported to the IRS.

Tax law generally allows businesses to create "captive" insurance companies to protect against insurance risks and provides that certain small non-life insurance companies can choose to pay tax only on their investment income under Internal Revenue Code section 831(b) ("micro-captives"). 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 previously identified certain micro-captive transactions as transactions of interest in Notice 2016-66. Recent court decisions in the Sixth Circuit and the U.S. Tax Court ruled that the IRS lacks authority to identify listed transactions and transactions of interest by notices, such as Notice 2016-66, and must instead identify such transactions by following the notice and public comment procedures that apply to regulations.

Treasury and the IRS disagree with these decisions PDF that the IRS lacks authority to identify listed transactions by notice and continue to defend listing notices in litigation except in the Sixth Circuit. Treasury and the IRS will, however, no longer take the position that transactions of interest can be identified without complying with notice and public comment procedures. Treasury and the IRS issued the proposed regulations to ensure that these decisions do not disrupt the IRS' ongoing efforts to combat abusive tax shelters throughout the nation.

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

Treasury and the IRS intend to finalize these proposed regulations after due consideration of public comments in 2023 and intend to issue proposed regulations identifying additional listed transactions in the near future.

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