

IRS Targets Captive Insurance Companies Owned by Closely Held and Middle Market Companies

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In February 2015, the IRS added certain small or “micro” captive insurance companies to its “Dirty Dozen” list of abusive tax scams for the 2015 filing season. In response to what it sees as an abuse involving a legitimate tax structure, the IRS commenced promoter audits of several captive manager/providers under Internal Revenue Code (IRC) Section 6700, the section that permits the IRS to impose a potentially confiscatory penalty on anyone who organizes and sells what IRS determines is an abusive tax avoidance transaction. In connection with these audits, the IRS systematically requests client lists and client information maintained by captive insurance managers. It has served document and information requests on many of those clients. The IRS is also auditing insurance risk pools operated by many captive managers for their client operating companies. The potential risk to a company whose captive insurance company is disqualified, either through disqualification of the captive or of the risk pool in which many of its premiums are invested, is substantial. The operating company can be subject to reversal of tax deductions taken for premiums paid along with penalties and interest. If your company maintains a captive insurance company qualified under IRC Section 831(b) (up to \$1.2

million per year premium), you should determine whether any of your captive insurance products are placed with a captive manager currently involved in a promoter audit. You should also notify your tax return preparer. If you are served with an IRS information document request, summons, or subpoena, it is important to retain knowledgeable tax counsel prior to any response. Your captive insurance manager will have its own concerns, which limit the guidance it can provide.

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