

## **Captive Policy & Tax Reform: Behind the Scenes**

**Ryan Work, Vice President, Government Affairs  
Self-Insurance Institute of America**

**2018 Kentucky Captive Association Conference**



# Is All Politics Local / Personal?



**Policy Gridlock**

**Fundraising**

**Power of Digital Campaign**

**National Focus**

**Primary Traffic**

# Politics: 2018 & Beyond

**Senate Seats – 33  
(Ds – 3 for majority)**

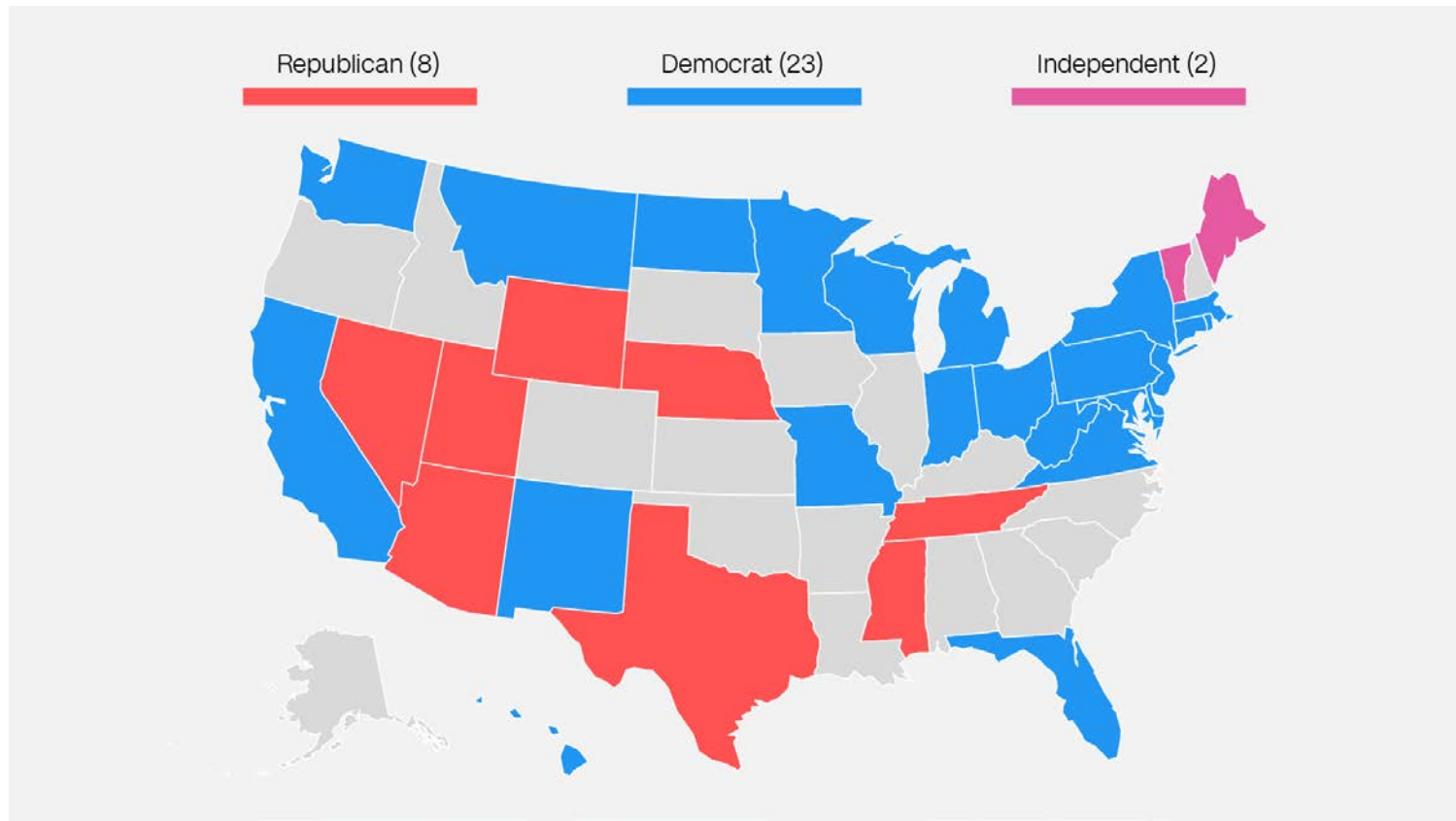
**House Seats– 435  
(Ds – 24 for  
majority)**

**Governorships -14**

**45 House  
Republicans/ 17  
Democrats  
departing**

**2020 Census/  
Election**

**Redistricting/  
Importance of PA,  
CA, NJ, NY**



# US Senate Landscape

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# Industry Advocacy



# AHP Proposed Rule



## AHP Formation:

- Related employers regardless of geographic location or;
- Unrelated employers *within the* same State/metro area.

## Key Items:

- Self-insured AHP treated as MEWA
- Self-employed individuals (“working owners”)
- Sole purpose of offering health coverage.
- Cannot refuse coverage based on health factors, cannot vary premium.

## Future for Self-Insurance

- Federal Pre-Emption is Critical (Class Exemption)
- Will there be a move to self-insurance AHPs after several years, ability to pre-empt state regulations.
- Self-insured AHPs may then access stop-loss/ captive risk.

# Self-Insurance Protection Act (SIPA)

*Protects self-insurance access to stop-loss, prohibits designation as health insurance*

**HR 1304**

- Legislative Hearing Testimony
- Committee Mark-Up

**April 2017**

- House Approved (400-16)

**Next Steps**

- Senate Introduction (Sen. Cassidy)
- Unanimous Consent Consideration

# IRS View of Captives

## Abusive Tax Shelters – IRS ‘Dirty Dozen’ List

- “These sophisticated schemes...can be peddled by promoters and others to avoid taxes.”
- “lack many of the attributes of genuine Insurance.”
- “...implausible risks, fail to match genuine business needs, or duplicate the taxpayer’s commercial coverages.
- “Premium amounts may be unsupported by underwriting ...geared to a desired deduction ...significantly higher than premiums for comparable commercial coverage. “
- “Captives may...advance inter-generational wealth transfer objectives and avoid estate and gift taxes. “





# SIIA Captive Activities

## Self-Regulation

- SIIA Captive Manager Code of Conduct

## Legislative/ Regulatory Changes

- PATH Act/ Clarifications
- Notice 2016-66
- Tax Reform

## IRS/ Treasury Meetings

- Education
- Notice Compliance Extension
- Viable Alternatives

## Educate & Meet with Congress

- General Captive Education
- Congressional & Industry Letters



Effective Date:  
Dec. 31, 2016

## Congressional Law Changes



### Incorporated in 2015 PATH Act

**I. Premium threshold increase from \$1.2 million to \$2.2 million (indexed to inflation).**

**II. Restrictions to prohibit estate planning and wealth transfer.**

#### Test 1: Risk Diversification

- No more than 20% of net written or direct premiums from any one policyholder.
- Related insureds are treated as one policyholder

#### Test 2: Ownership Test

- Family and lineal descendants cannot own more in the insurance company than the operating entity.
- 2% de minimis

# PATH Act : Unintended Consequences



- In attempt to restrict transfers to step children/adopted children, language unintentionally labeled all spouses as a specified holders and restricted ownership in the captive.
  - Issues with community property law and attribution between spouses of business interests.
- Ownership calculation of specified holder could include all assets insured by the captive, including by unrelated persons.
- De minimis standard application and exceptions.
- Congressional discussions: No intention to restrict insurance transactions between unrelated parties.

# PATH Act Clarifications: 2018 Omnibus



1) Clarify look-through for reinsurance or fronting arrangements

2) Clarify specified assets( under Test 2 ) to mean aggregate amount of related assets owned by spouse/ relation.

- Two-year grace period when acquiring ownership through inheritance or death.

3) Spousal Clarification

JCT leaves up to Treasury Department guidance related to ownership, premiums, gross revenue, and factors taken into account under applicable State law for assessing risk.



# Notice 2016-66: Transactions of Interest

- **Nov. 2016: IRS issued Notice 2016-66 designating most 831(b) captives as “Transactions of Interest”**
- **Notice triggers disclosure requirements for both participants and material advisors**
- **Filing Requirements:**
  - **831(b) Captive owner has at least 20% of the captive AND:**
    - **The captives’ losses and loss expenses are less than 70% of premiums earned less policyholder dividends, or**
    - **Captive has made loans benefiting affiliates.**

# IRS Notice: Industry Impact

<b>Total 831(b) captives in survey</b>	<b>2,397</b>
<b>Total number of Forms 8886 and 8918</b>	<b>15,021</b>
<b>Total cost of compliance</b>	<b>\$22,186,800</b>
<b>Average cost per captive to file all Forms 8886 and 8918</b>	<b>\$9,257</b>
<b>Total hours of compliance</b>	<b>121,755</b>
<b>Average hours per captive for compliance</b>	<b>50.97</b>

- Annual cost to prepare Form 1120PC federal tax return: \$1,000 to \$4,000/ yr.
- Average cost to complete Notice reporting (per captive): \$9,257.
- Form 8886 IRS estimate: 10.16 hrs. recordkeeping/6.25 hrs. preparation.
- Form 8918 estimate: 9.79 hours for completion.

# IRS Notice: SIIA Advocacy Messages

- **ERC taxpayers placed under undue regulatory and reporting burdens.**
- **Notice broadly targeted for majority of participants, instead of being narrowly tailored towards abusers.**
- **Much of the info requested by the IRS is already provided to them through various required forms.**
- **IRS is ignoring congressional intent - PATH ACT**

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United States Senate  
WASHINGTON, DC 20510

December 20, 2016

The Honorable John Koskinen  
Commissioner  
Internal Revenue Service  
1111 Constitution Ave., NW  
Washington, D.C. 20224

Dear Commissioner Koskinen:

RE: IRS Notice 2016-68, Transactions of Interest – Micro-Captive Insurance

In December 2015, Congress passed and President Obama signed into law the Protecting Americans from Tax Hikes Act (PATH Act), which included provisions changing Internal Revenue Code Section 831(b) regarding certain insurance companies electing to be taxed only on taxable investment income, including certain captive insurance companies. One change increased the maximum annual premium income that an electing insurance company may have from \$1.2 million to \$2.2 million, and increased the new maximum for inflation. This positive change clearly shows congressional support for captive insurance companies. The second change sought to limit areas of suspected abuse within the captive insurance market.

Last month, the Internal Revenue Service (IRS) issued Notice 2016-66, pertaining to micro-captive insurance transactions. While I understand the IRS intends to obtain more information about Transactions of Interest regarding Section 831(b) micro-captive insurance arrangements, which is a reasonable goal, the notice imposes extensive reporting and disclosure requirements for a large group of taxpayers in this industry with respect to the insurer's last five years. Furthermore, the fact that the taxpayer comment deadline regarding the Notice is January 30, 2017, generally the same day the Notice's new reporting requirements go into effect, does not allow the IRS time to consider taxpayer comments prior to the effective date of the reporting requirements.

Based on concerns I have heard from my constituents, I request a simple 90-day extension of the date for disclosure, reporting and potential penalties imposed under the Notice, which in many cases would otherwise be January 30, 2017, and I encourage the IRS to review any comments and consider revisions before these requirements take effect. While I fully support compliance with the federal tax code and eliminating tax abuse and tax fraud, imposing disclosure requirements on a large number of small and medium-sized businesses that use captive insurance to insure their own risk before the IRS has carefully reviewed such taxpayers' comments is unfair and violates a basic principle of administrative process.

Thank you for carefully considering this request. If I may be of help, please contact me or my staffer, Monica McGuire.

Sincerely,  


cc: John E. Clever, IRS, Office of Associate Chief Counsel (Financial Institutions & Products)

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20th District, Texas

CHAIRMAN  
COMMITTEE ON RULES  
COMMITTEE ON  
FINANCIAL SERVICES

Congress of the United States  
House of Representatives

April 6, 2017

The Honorable John Koskinen  
Commissioner  
Internal Revenue Service  
U.S. Department of the Treasury  
1111 Constitution Avenue, NW  
Washington, DC 20224-0001

Dear Commissioner Koskinen,

In 1986, Congress enacted Section 831(b) of the Internal Revenue Code to encourage businesses to form small captive insurance companies by, among other things, permitting the insurer to treat the premiums as non-taxable income up to a \$1.2 million limit. In 2015, Congress increased this limit to \$2.2 million.

A constituent has contacted me with concerns that the IRS is subjecting entities that make an election under Section 831(b) to "broad and burdensome" document requests, "invasive" audits, and litigation. In addition, the IRS published Notice 2016-66, which imposes extensive and retroactive disclosure requirements. I understand that the IRS has listed transactions involving captive insurance companies on its list of "dirty dozen" tax scams and that more information from taxpayers may help the IRS to distinguish tax abuse from bona fide insurance transactions. At the same time, it is concerning that the actions of the IRS likely discourage small businesses from utilizing captive insurance companies, thus interfering with the intent of Congress when it enacted Section 831(b).

In order to better understand how the IRS gathers information and takes action against entities that utilize captive insurance companies and the Section 831(b) election, I request that you please provide the following information:

1. *What guidance, if any, can an entity that uses a captive insurance company for a bona fide insurance purpose follow to minimize the likelihood that it will be subject to excessive document requests, lengthy audits, and litigation?* Notice 2016-66 states that the IRS and Treasury Department lack sufficient information to identify which Section 831(b) captive arrangements are to be identified specifically as a tax avoidance transaction. The Notice further states that the IRS and Treasury also may lack sufficient information to define the characteristics that distinguish tax avoidance transactions from other Section 831(b) transactions. Good actors seeking to use a captive insurance company for a bona fide insurance purpose should not be subject to such uncertainty.

The Notice does appear to identify a variety of characteristics that may indicate that a captive insurance company is being used for tax abuse. These characteristics include duplicate coverage, "coverage of an insurable risk," coverage that "does not match a business need or risk of insured," or a description of coverage that is "vague, ambiguous, or illusory." I believe that guidance would be more helpful if it were less subjective in nature.

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United States Senate  
WASHINGTON, DC 20510-0609

November 22, 2016

Commissioner John Koskinen  
Internal Revenue Service  
1111 Constitution Ave, NW  
Washington, DC 20224

Dear Commissioner Koskinen:

I write to express my concerns about IRS Notice 2016-66 regarding captive insurance companies ("the Notice").

It is my understanding that the IRS is attempting to acquire more data regarding captive insurance companies, many of which serve small businesses in Colorado that are seeking to mitigate their risk. I am concerned that the Notice is overbroad and may be burdensome for small businesses to identify transactions involving captive insurance companies over the course of many years. While I understand the IRS' need to identify and stop tax avoidance schemes, it is my hope that the Service can collect this information in a less burdensome manner or use data it may already have.

If you have any further questions regarding this issue, please do not hesitate to follow up with me.

Thank you in advance for your attention to this matter.

Sincerely,  
  
Michael F. Bennett  
U.S. Senator

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# Congressional Intervention



# What's Next?

- **IRS reviewing filings:**
  - **Abusive vs non-abusive structures.**
- **IRS will determine whether certain ERC captives will be:**
  - Deleted from TOI category
  - Designated as Listed Transactions
  - Potential for Global Settlement Initiative



# IRS Commissioner

- **Koskinen's term ended earlier this year.**
- **Asst. Treasury Sec. Tax Policy David Kautter serving as Acting Comm.**
- **President has nominated tax fraud attorney Charles Rettig**
  - **Chaired IRS Advisory Council**
  - **Active in ABA Tax Section**



# State Self Procurement Taxes

- **Microsoft Cease & Desist**
- **Dodd-Frank Implications**
  - **Non-Admitted Reinsurers Act**
- **Captive Domicile vs. Non-Domicile**

# Questions & Comments

*Ryan Work*  
*rwork@siaa.org*

**SIIA National Conference**  
Austin, TX  
September 23-25, 2018

