

Micro-Captive Reportable Transactions Regulations Finalized; Challenged

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On January 10, 2025, the Internal Revenue Service (IRS) and Treasury Department finalized regulations ([REG-109309-22](#)) that identify certain micro-captive insurance transactions, as well as transactions that are “the same as, or substantially similar to” those micro-captive transactions, as “listed transactions.” In addition, certain other micro-captive transactions are identified as “transactions of interest.” Both listed transactions and transactions of interest are “reportable transactions,” a category of transactions that requires material advisors and certain participants in the transaction to file disclosures with the IRS.

BACKGROUND

The final micro-captive regulations were preceded by an extended period of IRS scrutiny of micro-captive arrangements and public debate over the IRS’s aggressive approach to micro-captives. So-called “abusive” micro-captive arrangements were first included in the IRS’s annual “Dirty Dozen” list of tax scams in 2015. In the years that followed, the IRS issued notices directed to disclosure and list maintenance obligations, announced a micro-captive campaign, and issued proposed regulations. At each step, micro-captive advisors and participants demonstrated their vigorous disagreement with the IRS’s position. However, the IRS has generally prevailed in a series of cases litigated in the United States Tax Court and shows no sign of compromising its position on micro-captives.

Notice 2016-66, published on November 21, 2016, first identified certain micro-captive transactions as transactions of interest, with accompanying disclosure and list maintenance obligations. The notice was effective retroactive to November 1, 2016, and targeted transactions in existence as of November 2, 2006. Moreover, affected parties were required to file their disclosures with the Officer of Tax Shelter Analysis (OTSA) in the Large Business & International (LB&I) Division by January 30, 2017, in order to timely comply with Notice 2016-66. Comments were received in response to Notice 2016-66, including from Sen. Johnny Isakson, R-Ga., who requested an extension of the deadline, stating, “[T]he 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.” See 2016 TNT 247-16.

On January 17, 2017, Notice 2017-08 was published, providing an extension of time to May 1, 2017, for participants and material advisors to file their disclosures. On January 31, 2017, the IRS announced a number of compliance

campaigns, including the micro-captive compliance campaign. While the IRS began identifying taxpayers and digging into micro-captive audits, advisors continued to challenge the reporting and penalty regime described by Notice 2016-66. In 2022, Notice 2016-66 was vacated when the court determined that it constituted a legislative rule, thus the IRS was required to follow notice-and-comment procedures, which it did not; and the Notice was further found to be arbitrary and capricious. See *CIC Servs., LLC v. IRS*, 592 F. Supp. 3d 677 (E.D. Tenn. 2022). Subsequently, the IRS and the Treasury Department issued proposed regulations in April 2023 and made Notice 2016-66 obsolete.

MODIFICATIONS PRESENT IN FINAL REGULATIONS

The final regulations substantially adopt the prior proposed regulations, with certain modifications intended to clarify issues raised by public comments to the proposed regulations. As expected, the final regulations require both participants and their material advisors in micro-captive listed transactions and micro-captive transactions of interest to timely file disclosure statements with the IRS (i.e., Form 8886, *Reportable Transaction Disclosure Statement* for participants and Form 8918, *Material Advisor Disclosure Statement* for material advisors).

In response to over one hundred public comments to the proposed regulations, the final regulations include a number of modifications, such as narrowing the definition of a micro-captive listed transaction. In order for a micro-captive insurance transaction to be designated as a listed transaction, a conjunctive test is applied. The transaction must meet both a “loss ratio factor” and “financing factor” in order for the transaction to be designated as a listed transaction.

Also in response to public comments, the final regulations lower the loss ratio factor for purposes of designating a micro-captive transaction as a listed transaction to 30 percent. Commentary to the final regulations cite the Tax Court’s holding in *R.V.I. Guar. Co., Ltd. & Subs. v. Commissioner*, 145 T.C. 209 (2015) as support for that change, as well as reference concerns in public comments that the previously proposed 65 percent loss ratio factor had the potential to regularly capture insurance transactions that are not tax avoidance transactions.

NO TIME WASTED

On the same day that the IRS released the final regulations, Ryan, LLC, a global tax services provider that manages captive insurance companies for its clients, filed suit challenging the final regulations in the District Court for the Northern District of Texas in *Ryan, LLC v. Internal Revenue Service*, N.D. Tex., No. 3:25-cv-78. *Ryan, LLC* argues that the IRS exceeded its statutory authority, and that the final regulations are contrary to law, and arbitrary and capricious. The lawsuit additionally asserts that the final regulations violate the Administrative Procedure Act, while imposing additional limitations and burdens upon the use of captive insurance companies that Congress has not authorized.

CONCLUSION

The changes implemented by the final regulations, taken together, are expected to limit the volume of transactions that qualify as micro-captive listed transactions. The final regulations are effective as of January 14, 2025. Given the alacrity with which litigation challenging the final regulations has been instituted, it appears that final regulations may not be the last word in the long-standing debate over the use of micro-captive arrangements.

If you have any questions, please contact the authors or your Winston & Strawn relationship attorney.

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