

Charles Ruchelman Discusses Micro-Captive Transaction Disclosures with Accounting Today

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Taxpayers were required to file disclosures of so-called “micro-captive transactions” with the Internal Revenue Service by May 1st, and many of them found it wasn’t so easy.

“Notice 2016-66 laid out who is a participant in such a transaction,” said Charlie Ruchelman, an attorney at Caplin & Drysdale who helped his clients with the disclosures. “The IRS described the transaction, identified the types of participants and then instructed the participants to file the Form 8886, which is the reportable transaction disclosure. The participants that had to file were the captive insurance companies themselves, the insured entities who are being covered by the insurance policy, as well as the owners of the insured. Typically these are privately held companies that are running different businesses across the country, who purchased the insurance to cover themselves. It turns to be a tremendous undertaking. Most companies have more than one owner, and frequently there’s more than one insured if you have a company with multiple type of businesses attached to it.”

Micro-captives were required to report in-depth information on the types of coverage they had, their reserves, any related parties, any claims, and who the actuary was who priced the policies. “It was a lot of information, and it required a lot of expertise, not only to understand what is required under the reportable transaction rules in 6011 of the Internal Revenue Code, but also you have to have knowledge of the captives, factual and legal, as to how they operate and what’s relevant and would be responsive, and then compile all that on a form to file by May 1,” said Ruchelman. “There are thousands of captives in the United States, so the IRS got thousands of documents. Besides that, all the material advisors had to file too, and that’s on the Form 8919. You can have multiple advisors for a particular structure. You can have a captive manager. You can have the actuary. You can have an accountant. You can have an insurance advisor. You could have two or three advisors reporting, just for one transaction. It was a very heavy lift, a lot of work.”

Ruchelman and his law firm were involved in advising individuals, captive managers, actuaries, accounting firms and other law firms on how to report the information. He isn’t so sure the new rules will curb any possible abuses and wonders what the IRS will do with all the disclosures it received.

“What is the IRS’s next move? That is the question,” said Ruchelman. “Are they going to come out with some guidance that tells people what’s abusive and what’s not? I doubt it. They never seem to do that. I think they’re going to examine a lot of these and maybe work the cases through the Tax Court. I think the industry would welcome guidance from the IRS and they would comply, but there’s been a dearth of guidance besides the statute. The statute, 831b, tells the taxpayer that if they satisfy these elements and these requirements, the premium income is not taxable to the insurance company. That’s the state of play right now. We’re in the early stages, I think, of the enforcement and development of the law.”

The new reporting obligations may well discourage companies from setting up micro-captive entities. “It’s another administrative and regulatory expense,” said Ruchelman. “It will have an impact on either participants or managers deciding to either facilitate or participate.”

Accounting firms may find themselves dealing with the extra paperwork as well. “Accounting firms have been helping with the filings and also wondering whether they themselves are material advisors or potentially material advisors with respect to these transactions,” said Ruchelman. “Normally I think the regulations exclude tax return preparation [activities] to the extent they’re reasonable, so those activities would not be considered being a material advisor, but if the accountants’ advice went beyond that, then they could potentially be considered a material advisor.”

To view the full article, please visit *Accounting Today’s* website.

Excerpt taken from the article “IRS Micro-Captive Disclosures Prove Burdensome” by Michael Cohn for Accounting Today.

Attorneys

Charles M. Ruchelman

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