September 26, 2023

The Honorable James Lankford
The Honorable Markwayne Mullin
United States Senate
Washington, DC 20510

The Honorable Frank Lucas
The Honorable Tom Cole
The Honorable Kevin Hern
The Honorable Stephanie Bice
The Honorable Josh Brecheen
United States House of Representatives
Washington, DC 20515

Re: Objection to IRS Notice of Proposed Rule Making 4-1023

Dear Sirs,

The undersigned tribal jurisdictions submit their strong objections to the proposed rulemaking efforts by the Internal Revenue Service ("IRS") regarding what it terms micro-captive insurance structure. In 1986, Congress amended the Federal Tax Code to provide for a small insurance company exemption under IRS §831(b). The purpose was to facilitate the growth of small businesses by allowing them to self-insure thereby taking control over their risk management, insurance costs and enjoy the benefits of their own underwriting profits. The law has been an overwhelming success.

From the inception of §831(b), the IRS has fought the implementation and use of a legal tax micro-captive insurance tax election. The history of IRS activities is set forth in their *Notice* and will not be repeated here in full. But it is important to highlight, in 2002, the IRS identified small captive insurance companies as "listed transactions," in effect stating there was a presumption that they were abusive tax schemes. The evidence proved otherwise, and in 2004 micro-captives were removed as listed transactions. In December 2013, the IRS issued *Internal Revenue Number: 201351006*. This was a memorandum letter in response to a request that certain transactions qualified as insurance for tax purposes. The letter is attached hereto, but in summary, the IRS determined that small captive arrangements utilized by car dealerships to self-insure collateral protection insurance and other car related products was insurance for Federal tax purposes. This allowed these small captives to provide coverage and for their owners to benefit from the underwriting profits. They even carve out an exception in their *Notice* (see page 40 of *Notice*) to exclude those captives from the proposed regulations. As you also can see, the IRS cites to many of the same cases in its 2013 *Memorandum* to conclude that small captives in the car business were non-abusive, legitimate insurance transactions, that it now uses in the 4-10-23 *Notice* to argue that non-auto small captives are abusive.

Since 2013, the number of non-auto small businesses making the legal §831(b) election has increased dramatically as businesses sought to take advantage of the same benefits afforded car dealers. Meanwhile, rather than restrict the use of §831(b), Congress, in its wisdom has consistently increased the threshold for being deemed a small insurance company for purposes of the §831(b) election. The initial $1,200,000 ceiling for insurance premium a captive can collect and not be taxed was increased to $2,600,000. The IRS efforts to restrict the use of §831(b) runs contrary to efforts by Congress to make the election more attractive and beneficial. The

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failed *2016-66* I.R.B. effort was the IRS' latest attempt to designate an otherwise legal tax election as tax abusive. The United States Supreme Court emphatically crushed the effort on both procedural and substantive grounds. Now, the IRS is back at its drawing board. It seeks to circumvent major rulings in the *CIC* and *Mann Construction* cases regarding captives because it "disagrees" with the holdings.

The IRS opines that since the introduction of *2016-66*, tax courts have handed down four rulings that determined abusive micro-captive transactions (see page 25 of the IRS *Notice*). Those rulings are both isolated and lack sufficient context in the manner the IRS uses them in the *Notice*. First, the facts of all four cases were extreme and hardly apply to the vast number of captives now actively self-insuring. The signatories on the *Notice* are from the jurisdictional home to over a thousand captives, which increases every year. Second, what the IRS does not disclose is they cherry-picked the four cases. The IRS has over a thousand such alleged abusive cases they are unable to move forward. In most instances, the facts do not support their argument for abuse, and require time and effort which the IRS is unwilling to commit. What they are trying to do here is take a handful of extreme fact-based cases and fashion an argument for a pervasive change in the laws that would virtually destroy the industry because it does not like the §831(b) election available to taxpayers who wish to self- insure via micro-captive insurance structure.

A crucial part of our objection goes to the fundamental nature of how insurance is regulated. Neither the IRS, nor the Federal government has authority to regulate the insurance industry. Under the 1945 *McCarren Ferguson Act*, 15 U.S.C. §§ 1011-1015, Congress left the regulation of insurance to the States. While the IRS has limited authorization to determine if a transaction qualifies as insurance for tax purposes, it cannot regulate insurance. The IRS purports to use the rule making process to, in effect, regulate how captive insurance is transacted. First, it proposes to amend *26 CFR Part 1* to make a captive insurer a listed/prohibited transaction if it does not pay 65% of its insurance premium in loss claims during what it terms the "loss ratio computation period." It states if the captive does not experience a 65% loss ratio, it must be an abusive transaction. No State regulatory agency has such a requirement. The goal behind insurance is to write profitable business, to limit claims, and increase underwriting revenue. The IRS' minimum percentage premium proposal punishes a profitable block of business by creating the presumption that if the captive is profitable, it must be abusive. Second, the proposed amendment designates a captive as a listed transaction if during the financing computation period the captive loans money to an affiliated entity. That is what captives do. Automobile dealers use captives for exactly that purpose. There is no rational basis to force non-car dealer captives to limit their loan capability/asset investments to avoid becoming a listed transaction.[1] As long as the loan is an arm-length transaction, this provision makes no legal a sense.

Perhaps the most obvious problem is equating 100% ownership of a captive with it being an abusive transaction. The IRS states:

> "As further discussed in sections B.1. through B.3. of this Explanation of Provisions, the Treasury Department and the IRS have determined that two categories of micro-captive transactions, described in proposed §1.6011-10(c)(1) and (c)(2), are tax avoidance transactions, and thus propose to identify such transactions as listed transactions. The transactions in both categories involve related parties, including <u>a Captive, at least 20 percent of the voting power or the value of the outstanding stock or equity interest of which is owned, directly or indirectly, by an Insured, an Owner, or persons Related to an Insured or an Owner.</u> <u>See</u> proposed §1.6011-10(b)(1)(iii)."

Contrary to the traditional history and usage of captives where one insured owned one captive insurance company, the IRS would make a "listed transaction" when any insured owned 20% or more of any captive. A "listed transaction" is defined by the Proposed Regulation as:

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[1] § 1.6011-10 Micro-captive listed transaction (b) (2) defines computation periods.

"The provision states that, except as provided in regulations, a listed transaction means a reportable transaction, which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011."

Again, the effect would be to destroy the small captive industry because the 20% rule would immediately make most captives listed transactions. The lion's share of captives are 100% owned by the insured and this would immediately cast a dark and ominous cloud over them by defining them as a listed transaction upon the promulgation of the Proposed Regulation.

The effect of these amendments is to alter existing congressional law and to restrict the use of the 831 (b) election because the IRS does not like the law passed by Congress and does not want to abide by federal district, courts of appeals, and Supreme Court case law. The effect on the non-auto captive industry will be catastrophic. To artificially differentiate between car dealers and non-car dealer captives, will virtually destroy the non-auto captive market. The undersigned tribal jurisdictions have become preferred jurisdictions of domicile because they offer appropriate regulation and ease of administration in that all business can be conducted in the continental United States. As a result, the passive income for tribal jurisdiction in fees and premium tax has become a substantial part of their income base. The IRS proposed rule not only violates the law, but it will stifle small business expansion and operation in this country. We are adamant that this proposed rulemaking must be stopped, in its entirety.

The harm not only affects businesses nation-wide, but it has a direct effect locally on Native American jurisdictions. The Modoc Nation is a federally recognized Native American tribe in northeast Oklahoma. As a sovereign Native American tribe, the Modoc Nation retains the right to domicile business operations within its territory. Our jurisdiction provides a secure, onshore, and business-friendly environment for companies to operate from. In particular, we frequently domicile insurance companies, including 831(b) captives. The Modoc Domicile has been incredibly positive for our tribe. The fees we collect from domiciling businesses, such as microcaptive insurance companies, have enabled us to provide extensive social services to our members. These services include childcare assistance, scholarships for higher education, improved housing, and more. Our tribal government has also reintroduced over 200 bison to the Modoc range as part of our commitment to conservation.

In conclusion, the IRS proposed rule is nothing but a new effort to accomplish what it failed to do with 2016-66. Having been soundly chastised by the Federal courts at virtually every level, the IRS has attempted to cure the procedural defects with *2016-66*, without addressing the substantive issues. The IRS does not regulate insurance and it's now trying to redefine a captive and impose regulatory requirements completely contrary to most state insurance agencies and most certainly contrary to the requirements of tribal jurisdictions. The notion that a captive must be owned by multiple unaffiliated owners is contrary to the definition of a captive. The effect will be to kill the non-auto small captive market under circumstances where there is no basis to differentiate between an automobile dealer small captive and a non-automobile small captive. The domino effect will be to eliminate a significant source of tribal passive income to the detriment of the tribes and the clients they service. The ability to manage insurance costs and enjoy underwriting benefits has become an integral part of American small business. The IRS Proposed Regulations will destroy this simply because it does not like the laws Congress has passed and increased limits, and the way courts have interpreted the IRS' overreaching efforts.

Best Regards,

Robert Burkybile III
Chief of Modoc Nation