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# IRS Should Work With Industry On Microcaptive Regs

By **Dustin Carlson** · 2025-06-30 14:47:34 -0400 · Listen to article

In January, the Internal Revenue Service finalized its proposed regulations on microcaptive insurance arrangements while largely ignoring the extensive input it received from industry professionals.

For over a decade, the IRS has treated these small insurance companies — typically used by small and mid-sized businesses to manage their risks — as presumptively abusive. It placed them on the "Dirty Dozen" list of tax scams, issued broad disclosure

requirements, and dragged hundreds of taxpayers into costly audits and Tax Court battles, often without distinguishing between legitimate risk management and bad actors. The IRS has mostly prevailed in these efforts.

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This approach has led to an escalating conflict between small captives and the IRS. And in light of recent developments, the refusal to engage in good-faith rulemaking is starting to look like a significant miscalculation. The IRS would be well served to change its approach and instead provide clear, commonsense guidelines for small captive owners to follow.

In response to the IRS' actions, taxpayers have begun to shift their tactics. Rather than slogging through Tax Court — where over 1,000 microcaptive cases are currently pending, and the quasi-judicial deck seems stacked against them — they're paying a minimum required deficiency and then turning around and suing the IRS for refunds in district court.

Swift v. Commissioner, a case argued before the U.S. Court of Appeals for the Fifth Circuit in April, is a great example of this shift.[1]

**Swift**

In Swift, the taxpayer sued the IRS in federal court after the IRS had prevailed in Tax Court.

What may matter most for the outcome in Swift is not the underlying facts, but the court where the case is being heard. During the initial arguments and court proceedings, the Fifth Circuit court showed significant skepticism toward

the IRS' position that the microcaptive was a fraudulent scheme.

U.S. Circuit Judge Edith H. Jones noted in **oral arguments** on April 1 that insurance policies were issued, premiums were paid, claims were filed and adjudicated, and insurance payouts were made. In other words, it appeared to the court that the plaintiffs' microcaptive was, in fact, insurance.

**Effect of Jarkesy and Loper Bright**

In the collective rulings from last summer, the U.S. Supreme Court made clear that the executive branch has overstepped its power in recent decades, and that it can no longer have quasi-judicial proceedings internally in which an agency serves as the executive, legislative and judicial branches rolled into one.

For example, in Securities and Exchange Commission v. Jarkesy and Loper Bright Enterprises v. Raimondo, the Supreme Court signaled that enforcement actions — like the IRS' treatment of microcaptives — require real due process, not internal tribunals in which the odds are stacked in the government's favor. [2]

**HDH Group**

In July 2024, HDH Group Inc., a subsidiary of Chicago-based HUB International and an insurance broker specializing in alternative risk solutions, filed a federal refund suit against the IRS in the U.S. District Court for the Western District of Pennsylvania. The lawsuit is contesting more than $6.5 million in penalties that were assessed between 2013 and 2018 related to captive insurance arrangements the company designed for its clients.

HDH argues that its captives all complied with IRS rules, but they chose to voluntarily close their program in 2018 after concluding the IRS would not accept their arrangements.[3] HDH's decision to sue is likely due to a sense

that they now have a chance of success, although the case is still **ongoing**.

**Time to Engage**

***Resource Issue***

Swift and HDH show that microcaptive taxpayers are starting to sidestep the Tax Court, especially as litigation costs continue to climb, and quasi-judicial fairness is questioned.

Interwoven in all this is the practical reality that the IRS is running low on resources. The IRS simply doesn't have the man power, budget or technical expertise to continue this fight indefinitely — particularly under a Trump administration that has prioritized reducing regulations and cutting back on enforcement actions at agencies across the executive branch. The longer this drags out, the greater the risk for the IRS that district courts will, in effect, codify new standards for microcaptives without its input.

Now would be a good time for the IRS to engage with the captive industry in good faith.

***Bad Actors***

Industry professionals have acknowledged that bad actors do exist. Clearly, some microcaptive arrangements have been tax shelters, and the games played by many captive managers with life insurance or other estate planning tools certainly appear to have been inappropriate. One example is Keating v. Commissioner, decided by the Tax Court in January 2024.

In Keating, a company known as Risk Management Strategies Inc. owned a captive that engaged in so-called loanbacks, or loans made by the captive to its owners, in order to purchase a number of questionable insurance policies, including premium-financed life insurance policies for the owners.[4] These

loans were also designed to be paid back after the owners' death, which added to the problems with the captive, as the documentation involved was sparse and unclear. The court found in favor of the IRS and ruled that the captive was not a bona fide insurer.

That said, the IRS must also recognize that the majority of microcaptive arrangements serve critical business needs.

During the public comment period for the final microcaptive regulations, the IRS heard from over 100 industry participants who want to operate transparently and in good faith, but they were ultimately ignored.[5] These are professionals with decades of experience in risk management and claims adjudication, who are willing to aid the IRS in making good regulations around Section 831(b). So far, the IRS isn't reciprocating.

***One Possible Solution***

One option that would take little time or resources would be for the IRS to look to its own settlement in Paul Puglisi & Ann Marie Puglisi v. Commissioner, among other similar scenarios.[6] Puglisi was resolved on Oct. 29, 2021, with the Tax Court accepting the IRS' concession of all taxes and penalties against the farm, and the taxpayer only paying a token $1 fee. The Puglisis used a microcaptive to insure against avian flu and produced extensive documentation showing their captive was legitimate.

In the face of a strong fact pattern, the IRS backed down. This outcome suggests that there are arrangements where the economic substance aligns with the insurance purpose, and could serve as the basis for future regulations.

What parts of these settlements could be used to help craft a regulatory landscape that works for everyone? The IRS conceded in Puglisi without issuing a substantive opinion, meaning taxpayers were left guessing about

what facts or structures matter.

The IRS should let the industry know what the Puglisis did right. If the IRS is serious about curbing abuse without stifling legitimate risk management, it should offer clear guidance drawn from a case it quietly walked away from.

*Final Rules Issues*

The final microcaptive rules that were issued earlier this year — especially the loss ratio requirements and retroactive look-back periods — are not in tune with the way insurance actually works.

Specifically, insurance claims are, by nature, volatile, and a legitimate captive may go years without enough losses to hit the thresholds, especially if the captive's owner manages risks well.

Real insurance — especially small business insurance covering low-frequency, high-severity risks — can involve long periods of time with few or no claims. Forcing a captive to retroactively justify itself based on a look-back period is a standard that no commercial insurer is held to, and punishes successful companies that avoid losses.

If new IRS Commissioner Billy Long wants to support small-business risk management, he will need to rethink these rules.

**Conclusion**

The industry is ready to work with the IRS on building a commonsense regulatory framework. If the IRS won't, the number of companies pivoting to federal courts and suing for refunds, as seen in cases like Swift v. Commissioner, will likely continue to rise. This could effectively create a body of law in which the IRS had no input, meaning the IRS risks losing control over the rules it wants to enforce.

To avoid this, the IRS should engage with industry experts with real risk management experience and clarify the rules based on cases like Puglisi to provide commonsense regulations that clearly separate abuse — like that in Keating — from legitimate captives. The longer the IRS fails to do so, especially given the Trump administration's continued deregulatory efforts, the more it will be forced to keep up a fight it may no longer have the resources to win.

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***Disclosure: SRA 831(b) Admin and the 831(b) Institute submitted comment during the public comment period for the final microcaptive regulations.***



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Best regards,

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