

Challenge to IRS Micro-Captive Rule Partially Survives Dismissal

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- A federal judge in Texas allowed some claims to proceed in a legal challenge to an IRS rule identifying some micro-captive insurance transactions as abusive.
- The rule highlights micro-captive arrangements where participants attempt to reduce their income tax liability using purported insurance contracts with a related entity that lacks characteristics of bona fide insurance.
- Judge Jane J. Boyle allowed Ryan LLC to proceed with its Administrative Procedure Act claim that the rule is arbitrary and capricious, but dismissed claims that the rule was contrary to the law or exceeded the agency's statutory authority.

The IRS failed to fully escape a legal challenge to a rule identifying some micro-captive insurance transactions as abusive after a federal judge in Texas allowed some claims to proceed.

The rule ([RIN 1545-BQ44](#)), [published](#) in January, highlights micro-captive arrangements where the participants attempt to reduce their income tax liability using purported insurance contracts with a related entity that lacks the necessary characteristics of bona fide insurance, like risk distribution.

Judge Jane J. Boyle of the US District Court for the Northern District of Texas Wednesday allowed Dallas-based consulting firm Ryan LLC to proceed with its Administrative Procedure Act claim that the rule is arbitrary and capricious.

In a micro-captive insurance arrangement, a company establishes [an affiliated entity](#) for its own insurance, typically when its risk profile doesn't match other products on the market.

But the IRS audits these transactions for their potential to serve as tax shelters, typically analyzing how they distribute risks and pay claims to employees.

Ryan, which helps companies set up micro-captive arrangements, [sued](#) to block the IRS rule the same day it was released. The company argued that the regulation was done by "executive fiat" and runs counter to Congress' intent, and that there's nothing inherently suspicious about micro-captive insurance.

Ryan sufficiently argued that the IRS didn't do enough to explain why the loss ratios and Owner-Financing Factor that it chose to highlight in the rule should separate abusive transactions from legitimate ones, the judge said.

The rule establishes loss ratios under 60% as "transactions of interest" and loss ratios

under 30% as “listed transactions,” both of which subject them to extra scrutiny and potential sanctions for being tax avoidance schemes.

The government said it established those ratios based on US Tax Court cases on the subject, also drawing from statistical analyses of loss ratios for national commercial property and casualty insurance companies.

The court “takes no position on whether the administrative record would provide a basis for a different outcome on the merits,” Boyle said.

But Ryan didn’t show that the rule was contrary to the law, or that it exceeded the agency’s statutory authority, the court held, dismissing those claims.

Lehotsky Keller Cohn LLP represents Ryan.

The case is [Ryan, LLC v. Internal Revenue Serv.](#), 2025 BL 396822, N.D. Tex., No. 3:25-cv-00078, 11/5/25.

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