June 15, 2020

The Honorable Steven T. Mnuchin
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

The Honorable Russel Vought
Acting Director
Office of Management & Budget
725 17th St, NW
Washington, D.C. 20503

RE: Executive Order 13924– Regulatory Relief to Support Economic Recovery

Dear Secretary Mnuchin and Acting Director Vought,

The Self-Insurance Institute of America, Inc. ("SIIA") is providing these comments in response to *Executive Order 13924– Regulatory Relief to Support Economic Recovery* ("EO") issued by the President on May 19, 2020. Specifically, SIIA and its members respectfully request that the U.S Department of the Treasury consider a review of Internal Revenue Service ("IRS") activities related to 831(b) captive insurance companies in general and specifically the recent IRS Letter 6336 (which expanded upon IRS Notice 2016-66) pursuant to the EO.

SIIA is a member-based association dedicated to protecting and promoting the business interests of companies involved in the self-insurance and captive insurance industry. SIIA's membership includes captive insurance managers (who represent thousands of American businesses) and industry experts, risk retention groups, third party administrators, excess/stop-loss/reinsurance carriers, and self-insured employers.

The EO states, "*Many businesses and non-profits have been forced to close or lay off workers, and in the last 8 weeks, the Nation has seen more than 36 million new unemployment insurance claims. Agencies should address this economic emergency by rescinding, modifying, waiving or providing exemptions from regulations and other requirements that may inhibit economic recovery, consistent with applicable law…*" After completing a number of filings and ongoing data requests, specifically Letter 6336 ("the Letter") in the midst of the COVID-19 National Emergency, SIIA and its members strongly believe that ongoing actions by the IRS against the captive insurance industry in general should be reviewed and considered for relief under the EO, as they pose both an undue financial burden and complexity on American small- and medium-sized businesses already reeling from COVID-19.

Section 5(b) of the EO gives agencies discretion to formulate and decline enforcement mechanisms for persons and entities that have made a good faith effort to comply with regulatory and statutory standards, including acting under pre-enforcement rulings. Further, Section 6 of the EO directs all agencies to consider principles of fairness in administrative enforcement and adjudications practices and procedures. Among those outlined, SIIA believes several subparts to Section 6 are worthy of notation vis a vis IRS actions against American businesses utilizing captive insurance to mitigate COVID-related claims:

a) *The Government should bear the burden of proving an alleged violation of law; the subject of enforcement should not bear the burden of proving compliance; and*

b) *Administrative enforcement should be prompt and fair*

e) All rules of evidence and procedure should be public, clear and effective.

g) Administrative enforcement should be free of improper Government coercion.

h) Liability should be imposed only for violations of statutes or duly issued regulations, after notice and an opportunity to respond.

i) Agencies must be accountable for their administrative enforcement decisions.

With the EO in mind, and instead of imposing numerous and ongoing regulatory burdens, SIIA respectfully request that the IRS be directed to more appropriately define captive guidance, while more efficiently and cost-effectively collecting the appropriate information regarding IRC § 831(b) transactions without hindering the recovery of the American businesses appropriately utilizing captive insurance to mitigate COVID-related risks. American businesses with captive insurance should not be treated by the IRS as guilty before proven innocent. The fact that the Service issued and demanded duplicative data in the midst of a national pandemic at the threat of perjury is signal enough of the gross negligence and violation of due process being undertaken by the IRS in this instance. These actions should be directed to cease.

831(b) Captives

Captive insurance companies allow participating businesses to pay premiums to an insurance company owned by that business, setting aside money and building reserves for potential future losses. In helping to mitigate current and future losses, captive insurance protects local businesses, employees and customers from catastrophic risk. Unlike a Fortune 500 company that uses larger captive insurance instruments, businesses utilizing 831(b) captives do not have massive financial reserves or capital market access to mitigate a significant loss.

Much like the rest of the country, the captive insurance industry is working hard to provide the support necessary to tackle COVID-19 and the economic impact it has on America's small and medium-sized businesses, their owners and employees. Many of our members work with businesses that have established captive insurance companies to mitigate against risks that are extremely relevant in the current times, including supply chain and business interruption, health care costs and other high severity, low frequency issues. In fact, when Congress established Internal Revenue Code Section 831(b) in 1986, it sought to provide a risk mitigation tool for exactly such purposes. It is important to note that many of these coverages are not available in the commercial market, and often are expressly excluded in commercial policies as many have experienced recently with business interruption issues.

Despite the Service's ongoing concerns of enterprise risk captives, or 'micro-captives,' these same insurance companies are now being vindicated as they help numerous small and privately held companies survive the COVID-19 crisis and beyond. There is no question that the types of low frequency, high severity risks covered in these insurance programs are implicated in this crisis, and these captives are gearing up to respond. In fact, on March 20th, *The New York Times* (NYT) published an article titled, "Once Scrutinized, an Insurance Product Becomes a Crisis Lifeline," in which it stated that, while the IRS is stepping up its crackdown on captive insurance abuse, "the vehicle may prove its worth during the corona virus outbreak."

IRS Letter 6336

On March 20, 2020, nearly 150,000 American business owners received Letter 6336 (3-2020) (IRS Letter), the very same day as the aforementioned NYT article. This letter was issued in the midst of a national emergency to many owners whose businesses are shut-down, inaccessible or operating at diminished capacity during and because of that emergency. Worse, the IRS Letter requires recipients to access and report information about their captive insurance program that might not be available to them because of the emergency, to report that information under penalty of perjury by May 4th, later extended to June 4th, or to otherwise face an increased risk of immediate audit.

As if the IRS could not have done something more clearly insensitive, thoughtlessly timed or astonishingly draconian, the IRS Letter, itself, is so unclear that taxpayers making good faith efforts to comply could inadvertently put themselves in a position to be accused of perjury. For example, the IRS Letter requires taxpayers who have ceased participating in micro-captive transactions to report the date they ceased participating. Unfortunately, there are any of a number of dates that could be reasonable responses to the question, including: the date the last insurance policy expired, the date the last insurance obligation was resolved, the date the captive surrendered its insurance license or the date the captive was liquidated. Taxpayers should not be required to respond to the IRS Letter until that question, which again must be answered under penalty of perjury, can be clarified.

Furthermore, the overall need for the IRS Letter itself should be reconsidered as it is possible for the IRS to deduce the answers to its questions from information that has already been reported by taxpayers using Form 8886. At a time when the Administration is working hard to assist these same businesses, many of which are closed and in dire straits, and the IRS is delaying filing and other tax requirements, this letter is ill-timed and aimed at hurting the same businesses that the Administration are aiming to help. SIIA, along with a number of state domicile associations including Arizona, Delaware, Montana, Nevada, Tennessee, South Carolina, Utah and Vermont, just to name a few, have also written to the Treasury with these same concerns.

Notice 2016-66

In November 2016, the IRS issued and made *immediately* effective, without public comment, Notice 2016-66 ("the Notice") labeling most captive[1] insurance arrangements within §831(b) as "transactions of interest".[2] The Notice requires reporting by any taxpayers involved in these transactions with open statutes of limitations for the past 10 years, meaning a larger number of taxpayers must comply with the reporting requirements. More burdensome, the filing deadline was originally set at January 30, 2017, just 90 days from the first issuance of the Notice. Upon further consideration after attention from Members of Congress, the IRS extended the filing deadline by 90 days to May 1, 2017, while providing no extension for comment submission.

The stated purpose in the Notice for collecting this additional information from taxpayers is "the Treasury Department and the IRS lack sufficient information to identify which § 831(b) arrangements should be identified specifically as a tax avoidance transaction and may lack sufficient information to define the characteristics that distinguish the tax avoidance transactions from other § 831(b) related-party transactions."

The criteria outlined in the notice have caused nearly all §831(b) captives to become transactions of interest and thereby subject to the applicable IRS regulations intended for abusive tax shelters. Participants were also required to disclose their participation on their individual and business tax returns or be subject to severe penalties,[3] regardless of whether their captive insurance arrangement contained any of the characteristics of concern identified by the IRS. Thus, thousands of taxpayers undertaking appropriate and legal structuring mechanisms have been significantly burdened (and may be potentially fined) because the Notice is broadly targeted for practically all participants, instead of narrowly tailored to the abusers. These same taxpayers are now being required to submit this same exact information in yet another form, and under penalty of perjury, as part of Letter 6336.

Regulatory Burden

The Notice and recent Letter require taxpayers to report information almost all of which the IRS already has in its possession. For example, captives must file an annual tax return on Form 1120-PC clearly indicating if they are a §831(b) electing company. The tax return is often required to include a copy of the insurance company's annual

[1] A captive insurance company is often defined as an insurance company that has a common owner with the business being insured. The captive is given a limited purpose license to sell insurance only to the related party or controlled group. Approximately 80% of all Fortune 500 businesses have a captive insurance company. Often, a captive provides these large businesses with significant tax benefits. The use of captives by small and middle market businesses is not tracked, but rough estimates place the numbers in the thousands. These small captives typically elect the tax benefits designed for small insurance companies under §831(b).

[2] A transaction of interest is a transaction that the IRS and Treasury believe has a potential for tax avoidance or evasion, but for which the Notice asserts there is not enough information to determine should be identified as a tax avoidance transaction. The material advisors to the transaction must file Form 8918 and maintain a list of clients to be furnished to the IRS upon request.

[3] There are strict liability fines for failing to provide complete and timely filings of up to $10,000 per individual and $50,000 per business, in addition to the time and expense involved in individual business compliance.

statement which it files with the state (or domicile) insurance regulators. The duplicative information that the IRS requires in the Notice but is already receiving includes the captive's premium, losses, loans, expenses, domicile location, assets, and the names of any shareholder with 50% or greater ownership. Often these filings also include the lines of coverages and actuarial information.

Additionally, it is an extreme burden on taxpayers to review files and report information going back 10 years and provide this information a second time. While the IRS has stated itself that it does not have the capabilities or resources to identify past owners and collect information as far back as 10 years old, it somehow expects the industry to do so for them.

Since most captive have at least one business and one shareholder that also reports, and many have dozens of each, multiplying that number by the several thousand § 831(b) electing captives that are subject to this Notice, the total number of taxpayers who have filed the reportable transaction forms is in the tens of thousands. Due to the fact that the IRS does not have a system to accept these returns digitally, it received thousands of hard copy paper filings. It has yet to be determined how they will manage to accommodate and review this large number of paper filings in a timely and accurate manner.

As SIIA outlined to the IRS in comments submitted on January 30, 2017[4], Notice 2016-66 imposes an undue financial burden and creates undue complexity for small and medium sized businesses, all for little or no benefit to the IRS. These requirements have come at a tremendous cost to taxpayers. The Notice requires detailed information about captives to be filed on a Form 8886. Under the Notice's requirements, not only does the captive insurance company file this form, but so do the businesses that are insured by the captive, as well as the current and even prior owners of the business that are insured by the captive. The time, effort and cost to collect, prepare and file all the Form 8886s required by the Notice took over 7,500 hours and cost over $1.2 million for SIIA members alone, averaging 62 hours per form at a cost of nearly $10,000 per filing. This is well above the 10.16 hours for recordkeeping and 6.25 hours for preparation estimated by the Service, which is a gross underestimate.

Additionally, the IRS requirement that a separate form (with the exact same information) from each owner of the captive and each owner of the business with duplicate information multiplies the cost for no possible additional benefit to the IRS. This form, 8819 filed by material advisors and actuaries, took each filer an additional 17 hours with a cost of nearly $2,500 per form. Again, the IRS underestimated a mere 9.79 hours for completion. In total, SIIA members spent nearly 10,000 hours at a total cost of $1.6 million dollars to file the additional 8819.

To sum up the regulatory burden and cost, just for SIIA members alone, both forms combined cost of over $3.5 million and around 25,000 hours to complete and file

4 See SIIA Comments.

per year. Keep in mind the annual premium limit on 831(b) captives itself is approximately $2.3 million. In one egregious instance, a captive with just three owners and a mere $200,000 in annual premium had to file 143 separate forms on a single captive, spending more money in regulatory filing under the Notice than its annual premium. In another example, a physician who retired from his practice and closed his captive in 2011 received IRS letter 6336 in April of this year, over 9 years after the closure of his practice.

Finally, it is worth noting that there does not seem to be much, if any, benefit to the IRS for all of the information it requires to be filed. As you know, in our federal system, States have authority and jurisdiction over the regulation of insurance – a fact that the IRS appears to be ignoring in this case. A number of state domicile associations, including Arizona, Delaware, Georgia, Kentucky, Montana, Nevada, North Carolina Tennessee, Utah, and Vermont have expressed similar concerns on this issue.

Given the current situation, combined with the timing and burden being placed on these businesses by the IRS, the Self-Insurance Institute of America (SIIA) and its members ask that the IRS cease such requests and allow businesses operating captive insurance to mitigate the risks that Congress and the tax code allows them to appropriately undertake.

While we understand the IRS's ongoing concern over certain 831(b) captives, the fact remains that the vast majority of the industry and businesses who operate captives are doing the right thing and complying with all state and federal financial filing requirements. This letter, and other IRS actions, can reasonably be viewed as harassment. This flies in the face of the underlying Internal Revenue Code and is contrary to recent actions by Congress as outlined in the *PATH Act*, provisions of which the IRS has yet to issue guidance on nearly 5 years after enactment, and despite numerous congressional inquiries.

We greatly appreciate your consideration of these very important issues and would look forward to setting up a discussion with your staff to provide additional and concrete examples of the burden these activities pose to American business. If you have any additional questions or would like to discuss this further, please do not hesitate to contact me at (202) 595-0642 or rwork@siia.org.

Sincerely,

Ryan C Work

Ryan C. Work
Vice President, Government Relations
Self-Insurance Institute of America, Inc.