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RISK MANAGEMENT GROUP

**April 12, 2019**

**T.C. Memo 2019-34**

## Summary of the Tax Court Decision for Syzygy Insurance Company, Filed April 10, 2019


**Summary:**

The Tax Court determined that a micro-captive insurance company arrangement lacked risk distribution and was not insurance for federal income tax purposes.


**Facts:**

Syzygy is a micro-captive insurance company incorporated on December 31, 2008, and managed during the years at issue by Alta Holdings, LLC. From 2008 through 2011, Syzygy wrote premium and issued insurance policies with a layered coverage approach. The premiums were priced internally by a non-actuary without use of a rating model, calculations, or any other detailed analysis describing how he arrived at the premiums.

No direct claims were filed, with only one unrelated party claim paid during that period. The policies appeared to cover deductible reimbursement risks for which numerous losses occurred; however the insured failed to file claims with the captive as they were too numerous to list.

The majority of captive assets were directed to life insurance policies with restricted access to policy cash values. Claims-made policies were not issued to the insured until after the end of the policy period, and required that claims be made within 30 days of when the loss occurred or 7-days after the policy expired.

Captive manager correspondence included statements discussing how much premium was achievable and “wild ass guess” at premiums. Client correspondence noted displeasure with premium decrease and that they wanted the highest premiums they could get.

**Conclusion:**

The Court determined that premiums were not insurance premiums and therefore were not excluded under 831(b). The court noted that the arrangement lacked risk distribution, had no reasonable basis for allocation of premium to various coverage layers, and was not insurance in the commonly accepted sense.

Further, the Court noted that investment choices were troubling and weighed heavily the finding that >50% of captive assets were not available to pay claims.

The Court also determined that Syzygy charged unreasonable premiums and late-issued policies with conflicting and ambiguous terms.

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**Comparison of Syzygy to Oxford Program:**

| Syzygy Insurance Company | Oxford Program |
|---|---|
| Inappropriate manager and client correspondence | Attention to compliance and adherence to best practices throughout the program |
| Pricing of policies conducted in-house, no actuarial rating model or analysis describing how premiums were determined | Use of Best in Class, highly experienced and credentialed, independent actuarial firms, following established best practices and guidance |
| No reasonable basis for allocation of premium to various coverage layers | First dollar pool provides clear connection between allocation of related/unrelated claims |
| Policies late-issued after end of policy period, ambiguities and conflict over coverage | Timely policy issuance; policies provide clear and straightforward coverage consistent with insurance industry standards |
| Troubling investment choices, substantial life insurance and limited ability to pay claims | Reasonable investment plans, full access by captive manager to assets to meet claims payment obligations. |
| No direct losses, only 1 pooled loss in 3 years | Significant claims history; every loss is pooled loss |
| Client had significant losses which were unreported to the captive for payment, failure to file claims they thought were covered | Robust client services program and follow up, including annual client review, annual business meeting, newsletters, and seminars |
| Was not operated as a bona fide insurance company. Insurance-like traits did not overcome other failings | Close attention is paid to operating as a bona fide insurance company, with careful adherence to established insurance best practices |

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