Taxpayers Can't Designate Their Microcaptive Case for Litigation

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By Nathan J. Richman

The IRS's concession of the rest of the tax liability not conceded by the taxpayers left the court without anything to do despite petitioners' wish for an opinion on the matter, according to the Tax Court.

Christopher S. Rizek of Caplin & Drysdale Chtd. told *Tax Notes* that the IRS's concession of the vast bulk of its asserted deficiency in the microcaptive insurance case *Puglisi v. Commissioner* is the first taxpayer victory on the issue he has heard of since the agency started focusing on the issue in the last five or six years. Rizek is one the petitioners' attorneys.

Judge David Gustafson entered an order resolving the case on November 5, despite the petitioners' objection, by accepting the IRS's concessions. While the taxpayers and connected companies can't be criticized for strategically coordinating their efforts to present a strong case for a valid section 831(b) microcaptive insurance arrangement, neither can the IRS be criticized for seeing the weakness of its position in the case and tactically reallocating resources to cases more promising for its position, he wrote.

The petitioners weren't worried about section 7430 fees awards because they wouldn't have qualified, but they instead wanted to present their strong case for determination by the Tax Court to stand against the string of IRS wins — from *Avrahami v. Commissioner*, 149 T.C. 144 (2017), through *Syzygy Insurance Co. Inc. v. Commissioner*, T.C. Memo. 2019-34.

"We wanted an opinion," Rizek said. "But the net outcome is very taxpayer-favorable."

The IRS's ability to put an end to litigation in *Puglisi* could stand in counterpoint to the IRS's recent efforts to assure taxpayers, tax professionals, and Congress that it isn't using its procedure for designating cases for litigation — in which it denies taxpayers access to the Independent Office of Appeals if the agency wants a precedent — wantonly or frequently.

What Hatched

The petitions in *Puglisi* revolved around attempts by the owners of a family egg farm to obtain insurance against risks such as avian influenza. When the insurance the owners wanted wasn't available on the commercial marketplace, they obtained coverage using an insurance fronting

carrier licensed by Delaware. That insurance was then reinsured by the petitioners' captive insurance company.

According to the factual summary Gustafson assumed for deciding the IRS's motion for entry of decision, the farm filed five claims since 2015 that were covered by the policy the IRS examiners claimed was illusory.

For tax years 2015, 2016, and 2018, the IRS had asserted over $2.1 million in tax deficiencies and nearly $700,000 in penalties based on its conclusion that the insurance lacked economic substance.

Gustafson noted that not only had the IRS conceded the bulk of the deficiencies in the six cases joined as *Puglisi*, but in June the court entered stipulated decisions on two cases filed by the petitioners' microcaptive insurance company. In those cases, the IRS conceded $610,000 of asserted tax deficiencies down to $1 between two years and no penalty.

In *Puglisi*, the parties in April entered a stipulation reducing the petitioners' 2015 management fee expense deduction claim from nearly $2.7 million to $2.57 million and allowing more than $800,000 of insurance deductions for 2015 and 2016. In May the IRS conceded everything else and moved for an entry of decision.

Spilt Milk

In weighing the petitioners' opposition to the IRS's motion, Gustafson started with the basics of the Tax Court's jurisdiction in a deficiency case. "Stated simply, a deficiency is an *amount* — in particular, 'the amount by which the tax imposed * * * exceeds * * * the amount shown as the tax by the taxpayer upon his return,'" he wrote, citing section 6211(a) (emphasis in original).

In a deficiency case, the Tax Court's job isn't to review the whole of the IRS's actions under the Administrative Procedure Act but merely to redetermine any deficiency the IRS asserts, Gustafson said. Without any dispute about the amount of tax or penalties owed, it's time for the court to issue its decision, he continued.

The petitioners aren't disputing the amount of the decision but just want an opinion ahead of it, according to Gustafson. Unfortunately, that desire runs headlong into the general prohibition on issuing advisory opinions, he said.

While there's an exception for rejecting IRS concessions in some cases, it isn't appropriate for the petitioners' case, which would involve factual disputes leading to a lengthy trial, Gustafson said.

The petitioners in *Puglisi v. Commissioner*, Nos. 4796-20, 4799-20, 4826-20, 13487-20, 13488-20, 13489-20 (Tax Ct. 2021), were represented by lawyers from Caplin & Drysdale Chtd. and Frazer Ryan Goldberg & Arnold LLP.