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IRS granted concessions in Tax Court captive dispute

The concessions of the Internal Revenue Service (IRS) in a legal challenge of a captive insurance company have been accepted by a judge in a US Tax Court before trial.

Judge David Gustafson ruled in favour of the IRS' concessions in 'Paul Puglisi and Ann Marie Puglisi, et al v. Commissioner of internal revenue' that "eventually determined to concede the amounts of tax at issue (except for about 2 per cent that petitioners conceded) and to concede the penalties".

The petitioners in the case are the owners of Puglisi Egg Farms, a Delaware-based egg farm that formed a captive insurance company, Oxford Risk Management Group, in 2015 to provide coverage against avian influenza when commercial insurance became unavailable.

Oxford Risk Management Group served as a reinsurance company rather than writing direct insurance, whereby Puglisi bought insurance from a fronting company, which then entered into a reinsurance agreement with the captive.

Under the reinsurance agreement, Oxford Risk Management Group reinsured 20 per cent of all approved claims of Puglisi Egg Farms, and its quota share of 80 per cent of all proved claims of unrelated entities insured by the fronting company.

The IRS began its audit in 2017 by issuing statutory notices of deficiency for 2015 and 2016, later adding 2018 to total tax deficiencies and penalties of more than US\$27 million.

In its issuance, the IRS stated: "It is determined that the purported insurance and/or reinsurance transactions lack economic substance, that the substance of the transactions do not comport with their form, and that the various steps involved in the transactions were engaged in for no purpose other than to avoid or evade taxes."

Puglisi Egg Farms subsequently filed challenging cases. When the case moved to the US Tax Court, the petitioners responded to more than 200 discovery requests and supplied more than 1,000 additional documents.

The IRS then conceded the tax deductions following the discovery, but before the case

went to trial.

Although Puglisi Egg Farms objected to the motions for entry of decisions, citing “the interests of justice demand that these cases continue towards trial’ to meet “a resolution on the merits for petitioners”, the decision is undoubtedly a victory for the wider captive industry.

Oxford Risk Management Group, who was not involved in the audit, noted its congratulations to Puglisi Egg Farms.