

Standing on the shoulders of giants

Sean King of CIC Services discusses the firm's upcoming case against the IRS in the Supreme Court, what a win would mean for the industry, and the support they are receiving from the captive insurance industry throughout this legal process

What will your main points be for the Supreme Court case against the IRS?

Our main point is that our legal challenge to the regulatory mandate illegally imposed upon taxpayers by Notice 2016-66 (in contravention of the Administrative Procedures Act) is not an attempt to restrain the assessment or collection of a tax. Consequently, we are asking the Supreme Court to affirm that federal courts may enjoin enforcement of the illegal notice without running afoul of the Anti-Injunction Act. To be more specific, we contend that the information gathering and recordkeeping requirements imposed upon material advisors like CIC Services by Notice 2016-66 are so removed from the assessment and collection phases of the federal tax enforcement process that enjoining those requirements does not enjoin the assessment or collection of taxes.

Are you receiving support from the captive sector as you continue to defend your case against the IRS?

We have been encouraged and humbled by the outpouring of support we have received both inside and outside of the captive insurance industry. We would not be here without the support of high-caliber attorneys who took up the mantle to advance our case, the Antonin Scalia

Supreme Court Legal Clinic of the George Mason Law School, and many captive insurance regulators who have supported us in the case.

We have received a phalanx of industry support from Self-Insurance Institute of America (SIIA), the North Carolina Captive Insurance Association, the Tennessee Captive Insurance Association, the Kentucky Captive Insurance Association, the Missouri Captive Insurance Association, and the Oklahoma Captive Insurance Association. Many of our supporters in the captive industry also submitted "friend of the court" briefs as well.

We are also truly grateful for the outpouring of support we have received outside of the captive industry which highlights the importance of our cause well beyond the captive industry. In this case, we are "standing on the shoulders of giants" with Amicus Briefs submitted by the United States Chamber of Commerce, the CATO Institute, Professor Kristin E. Hickman of the University of Minnesota School Of Law, and the Tax Clinic at the Legal Services Center of Harvard Law School.

If you win, do you see a push back from the IRS on 'micro-captives' for the entire industry?

If we win at the Supreme Court the case will likely be sent back to the federal district court for

further consideration and a decision regarding whether or not an injunction should be issued. We are confident that we meet the standard for an injunction and that Notice 2016-66 would ultimately be enjoined by the district court. What the IRS does from there is anyone's guess, but the IRS would at a minimum be precluded from enforcing the notice and may also be precluded from making use of any data collected as a result of the illegal notice. That would be a big victory.

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The IRS could attempt to reinstate the notice by writing a new rule with substantially similar provisions, but that new rule would at least have to be created in accordance with the process prescribed by the Administrative Procedures Act. In other words, the service would have to give notice of a new proposed rule, give sufficient time for the public to comment on the notice, accept public comments, and incorporate the public feedback into any final rule that it might issue. Had this process been followed from the

beginning, the IRS would have had the industry's support and could have collected much more targeted and useful data more quickly.

What is your ultimate aim/goal, win or lose?

Our goal is to force the IRS from this point forward to comply with the requirements of the Administrative Procedures Act when imposing substantive obligations on taxpayers (like filing and record keeping requirements) that are not directly related to the assessment or collection of taxes. If we win, that will be the new law of the land. If we lose, then we'll have to turn to Congress for a remedy. Regardless, the IRS simply cannot be permitted to continue acting as a law unto itself with freedom to issue even obviously-illegal rules and to enforce those illegal rules against taxpayers with impunity while evading judicial scrutiny.

Many from the industry, including yourselves have been critical of the IRS' letter sent out to businesses early into the pandemic - do you think the US Congress will help the industry out as requested by many via letters?

The IRS made no friends in the industry or congress by sending that letter when and how it did. I'm confident that, despite the rhetoric, most enforcement activity against captives will ultimately be suspended until taxpayers are able to comply. It's simply unreasonable to expect taxpayers to comply with IRS demands during a time when those taxpayers are forbidden by lockdown orders from legally accessing the necessary records, obtaining the required legal or tax advice or are otherwise struggling just to stay in business.

Do you believe this pandemic will highlight the importance of captives, especially for small- to medium-sized businesses in the US?

Small businesses are critical to our country's economy. They employ nearly half of private sector workers and account for most of the job growth over the last ten years. And yet compared to Fortune 1000 companies that have more diversified business models and the ability to raise additional cash quickly in the capital markets, small businesses are uniquely fragile.

Few Fortune 1000 companies will go out of business due to this pandemic, but there's little doubt now that we're going to see millions of small businesses do so. The impact on the job market is going to be dreadful. It already has been. But those small businesses that had the foresight and the intestinal fortitude to insure against business interruption risks via a captive insurance arrangements even despite the IRS's hostility are unquestionably better off today than those who didn't. The former are far more likely to survive than the latter. We've seen several examples already of captive insurance arrangements

saving the bacon of small business owners, allowing them to stay open and preserve jobs despite lockdowns and the like.

In short, anyone caring about the ability of small businesses and their employees to support our economy must favour expanding the appeal and accessibility of captive insurance.

The pandemic has also exposed many of the IRS's traditional criticisms of certain captive insurance arrangements as unfounded. For instance, some risk pools that may have gone a few years without claims, a source of consternation to the IRS, will now have many massive ones. Policies that once many have appeared overpriced in the IRS's eyes suddenly appear cheap. Businesses with policies protecting against COVID-19 related risks like business interruption may have paid an arm and a leg for it at the time, but the fact is that now such coverage generally can't be obtained by businesses that lack it at any price.

It seems that the IRS was not smarter than the actuaries after all and that comprehensive business interruption insurance has been, if anything, long underpriced. ■

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Sean King
General counsel
CIC Services

