BUSINESS INSURANCE
WORLD
CAPTIVE FORUM

General Track: Update on Federal and State Tax Law Issues

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AGENDA

- Effect on Captives of IRC § 831(b) Decisions
- Washington State
- Johnson & Johnson v. Director (New Jersey)
- State and Local Taxes – Income Tax (New York)
- Passive Foreign Investment Company
- Economic Substance

EFFECT ON CAPTIVES OF IRC § 831(b) DECISIONS

- *Syzygy v. Commissioner*, TC Memo 2019-34 (April 10, 2019)
  - Taxpayer had burden of proof
  - Insured bought policies from Fronting Company (the pooling entity), which reinsured the lower layer to the affiliated captive, and a pro-rata share of pool participants' upper layers to the affiliated captive

EFFECT ON CAPTIVES OF IRC § 831(b) DECISIONS

- *Syzygy v. Commissioner*, TC Memo 2019-34 (April 10, 2019)
  - Fronting Company must be a bona fide insurance company:
    - Created for non-tax reasons?
    - Actual and insurable risks?
    - Whether comparable coverage was more expensive or available?
    - Met regulatory requirements
    - Claims paid from a separately maintained account?

EFFECT ON CAPTIVES OF IRC § 831(b) DECISIONS

- *Syzygy* – Risk Distribution
  - Circular Flow of Funds
    - Insured paid Front $1,373,500; Front ceded $1,319,055.76 to Captive
    - Cited *Avrahami* and *Reserve Mechanical* re: circular flow of funds

EFFECT ON CAPTIVES OF IRC § 831(b) DECISIONS

- *Syzygy* – Risk Distribution
  - Arm's-length Coverage
    - Rate on line for captives vs. commercial policies (6.1% v. 1.14%)
    - Excess coverage should be priced lower
    - No refund on cancellation of policies
    - Short period in which to file claims
    - Taxpayer switched its captive manager because premiums decreased

EFFECT ON CAPTIVES OF IRC § 831(b) DECISIONS

- *Syzygy* – Risk Distribution
  - Actuarially Determined Premiums
    - Premiums by underwriter who did not have an actuarial rating model or price comparison; at one point, he said premiums were wild guess
    - Ratio of 49% (lower layer) and 51% (upper layer) not actuarially determined
  - Captive manager did not testify to explain the program
  - Front not valid, thus no risk distribution

EFFECT ON CAPTIVES OF IRC § 831(b) DECISIONS

- *Syzygy* – Insurance as Commonly Accepted
  - Whether Captive is organized, operated and regulated as insurer
    - Properly organized and regulated
    - The question is whether the Captive was operated as an insurance company
      - Insured did not file $100,000 of claims for deductible reimbursement
      - More than 50% of the assets were invested in split dollar life insurance

EFFECT ON CAPTIVES OF IRC § 831(b) DECISIONS

- *Syzygy* – Insurance as Commonly Accepted
  - Minimum capitalization met
  - Valid and binding Policies – weighs against taxpayer
    - Centers on whether policies were timely issued, identified the insured and specified what was covered
  - Illiquid investments
  - Reasonable Premiums – weighs against taxpayer
  - Payment of Claims
  - Syzygy was not operated like an insurance company

EFFECT ON CAPTIVES OF IRC § 831(b) DECISIONS

- *Syzygy* – Other Issues
  - Non-insurance premiums may be deductible indemnification payments, but not here, where the insured did not file numerous claims
  - Rev. Ruls. 2005-40 and 2008-8 provide these alternatives (in addition to indemnification payments): loans, deposits and capital contributions (to the extent of net value)
  - Commissioner must follow applicable Revenue Rulings

EFFECT ON CAPTIVES OF IRC § 831(b) DECISIONS

- *Syzygy* – Other Issues
  - No evidence that recharacterization is appropriate
  - No Penalties:
    - Reliance on CPA's professional advice
    - *Avrahami* looked at lack of precedent in finding good faith

WASHINGTON STATE

- Washington State has neither a direct placement provision nor an industrial insured provision in its law and, in addition, has no direct procurement tax
- Accordingly, the issue is really one associated with Washington State, *i.e.*, all but a few other states have direct procurement legislation which address the taxation of premium paid to non-admitted insurers

WASHINGTON STATE

- Apparently, the state relied initially on RCW 48.14.090 which provides:

  In determining the amount of direct premium taxable in this State, all such premiums written, procured, or received in this State shall e deemed written upon risks or property resident, situated, or to be performed in this State except such premiums as are properly allocated or apportioned and reported as taxable premiums of any other state or states. For tax purposes, the reporting of premiums shall be on a written basis or on a paid-for basis consistent with the basis required by the annual statement.

WASHINGTON STATE

- However, RCW 48.14.090 seems to be more of a provision which determines what portion of premium of an authorized insurer is to be taxed on, as RCW 48.14.020(1) provides:

  Subject to other provisions of this chapter, each authorized insurer except title insurers shall on or before the first day of March of each year pay to the State Treasurer through the Commissioner's Office a tax on premiums. Except as provided in subsection (3) of this section, such tax shall be in the amount of two percent of all premiums, excluding amounts returned to or the amount of reductions in premiums allowed to holders of

WASHINGTON STATE

Industrial life policies for payment of premiums directly to an office of the insurer, collected or received by the insurer under RCW 48.14.090 during the preceding calendar year other than ocean marine and foreign trade insurances, after deducting premiums paid to policyholders as returned premiums, upon risks or property resident, situated, or to be performed in this State. For tax purposes, the reporting of premiums shall be on a written basis or on a paid-for basis consistent with the basis required by the annual statement. For the purposes of this section the consideration received by an insurer for the granting of an annuity shall not be deemed to be a premium.

WASHINGTON STATE

- MICROSOFT
  - Microsoft's captive, Cypress Insurance Company ("Cypress") initially received a cease and desist order and was assessed premium tax, interest and penalties
  - Apparently all based on property coverages placed directly from Microsoft in Washington State with its Arizona captive
  - The original order indicated that a significant number/percentage of directors resided in Washington State
  - Thus, the tax assessment in the order was based on the premium tax imposed on licensees

WASHINGTON STATE

- MICROSOFT
  - Reports of the settlement indicate
    - ❖ About 50% of the tax, interest and penalties would be paid, and
    - ❖ The property business would be placed through a surplus lines broker in the future
    - ❖ No mention was made with regard to any change in operational activities of the captive
    - ❖ The settlement applied the tax to Washington State risks only, and Microsoft agreed to place direct business on Washington risk through a surplus lines broker

WASHINGTON STATE

- SELF-REPORT MECHANISM
  - DOI comment that risk can be placed <u>only</u> with an admitted carrier or with an unauthorized carrier only through a surplus lines broker
  - DOI requested all captives to self-report per mechanism on its website:

WASHINGTON STATE

- SELF-REPORT MECHANISM
  - Generally, if self reported
    - Between 1/1/2019 and 6/30/2019 100% tax on premium, 100% interest plus 25% of tax penalty, plus $25,000 fine
    - Between 7/1/2019 and 12/31/2019 same regarding tax and interest but <u>50%</u> of tax penalty plus $100,000 fine
    - Between 1/1/2020 and 6/30/2020 same regarding tax and interest but <u>70%</u> of tax penalty and use of full fining authority
    - 7/1/2020 or thereafter same as to tax and interest but <u>100%</u> of tax penalty and full fining authority

WASHINGTON STATE

- RECENT DEVELOPMENTS
  - Alaska Airlines
    - ❖All entities based in Washington
    - ❖Captive domiciled in Hawaii
    - ❖Three years deductible reimbursement and SIR
    - ❖Portfolio transfer deductible reimbursements
    - ❖OIC seeks to tax all premiums

WASHINGTON STATE

- RECENT DEVELOPMENTS
  - CCW Safe, LLC (“CCW”) and 2A Insurance Company (“2A”)
    - ❖CCW legal service membership plan, domiciled in Oklahoma
    - ❖2A, a segregated account of Madison First Property and Casualty Ltd. SAC (“Madison”) domiciled in Bahamas
    - ❖CCW had been under investigation for acting without a license
    - ❖Order banning both
    - ❖Order does not prevent them from performing under outstanding contracts
    - ❖2% tax imposed/256 insureds
    - ❖<u>**NOT**</u> a Washington State-based entity

WASHINGTON STATE

- RECENT DEVELOPMENTS
  - Starbucks Corporation (“SC”)/Olympic Casualty Insurance Co. Ltd. (“OCIC”)
    - ❖ OIC argues SC is the named insured on most policies and under NRRA because Washington is the principal place of business, it is the home state
    - ❖ Proposed tax and fines
      - ➢ Potential fines @44 x $25,000 = $1,100,000 reduced to $25,000
      - ➢ Tax - $12,668,295
      - ➢ Interest - $5,632,202
      - ➢ Penalty $2,054,608 reduced under self-reporting to $513,652
      - ➢ But if SC rejects proposal penalties and fines go up to higher numbers

WASHINGTON STATE

- RECENT DEVELOPMENTS
  - Starbucks Corporation (“SC”)/Olympic Casualty Insurance Co. Ltd. (“OCIC”)
    - ❖ SC demands a hearing
      - ➢ Using a captive is self-insurance and OIC lacks authority to regulate self-insurance
      - ➢ OCIC not involved in the business of making contracts of insurance/its lone customer is SC/it is not an insurer under Washington law
      - ➢ OCIC is outside scope of regulatory authority under McCarren-Ferguson Act as state may only regulate business of insurance
      - ➢ Vermont has regulatory and taxing authority over OCIC, but even if OIC has authority it failed to properly exercise it, because (a) it must fairly apportion Washington premium tax consistent with state and federal law, and (b) it may not apply NRRA retrospectively.

WASHINGTON STATE

- RECENT DEVELOPMENTS
  - Starbucks Corporation (“SC”)/Olympic Casualty Insurance Co. Ltd. (“OCIC”)
    - SC demands a hearing
      - Apply analysis consistently TRIA vs. other
      - Treat cases alike/and estopped from doing otherwise
  - Cease and desist orders re: Alaska Airlines and Starbucks issued December 17, 2019

JOHNSON & JOHNSON v. DIRECTOR

- Johnson & Johnson located in New Jersey with captive domiciled in Vermont since 1994
- Policies included among others WC, AL, GL, PL, Excess PL, Executive Protection, Property, Miscellaneous Other Casualty
- IPT imposed in New Jersey on premium paid to non-admitted. J&J began paying tax in 2008 for years beginning with 2005. Paid only on New Jersey portion
- In 2011, after NRRA, paid tax on 100% of premium paid

JOHNSON & JOHNSON v. DIRECTOR

- J&J made claim for approximately $55,000,000 plus interest asserting that the New Jersey statute in response to NRRA was intended to apply only to surplus lines as it only refers to surplus lines
- New Jersey Tax Court concluded the legislation was intended to apply to both surplus lines and non-admitted premium
- Washington?

STATE AND LOCAL TAXES – INCOME TAX

- *Stewart's Shops Corporation* (NY Div. Tax Appeals)
  - Notes
    - ❖ Entity for years at issue owned 318-326 convenience stores and 820-1000 gas stations
    - ❖ Captive wrote multiple coverages including, *e.g.*, general liability, professional liability, auto liability, boiler and machinery, D&O, EPLI, umbrella liability
    - ❖ All risks in parent of captive which paid all premium
    - ❖ No deduction taken for federal income tax purposes

STATE AND LOCAL TAXES – INCOME TAX

- *Stewart's Shops Corporation* (NY Div. Tax Appeals)
  - Conclusion
    - New York State follows federal and, thus, no deduction for franchise tax purposes citing *Humana, Rent-A-Center* and *Securitas*
    - Affirmed *In the Matter of the Petition of Stewart's Shops Corporation*, DTA No. 825745

STATE AND LOCAL TAXES – INCOME TAX

- *In the Matter of the Petition of Moody's Corporation & Subsidiaries*
  - Issue whether Moody's Corporation ("Moody's") was required to include income tax of Moody's Assurance Company, Inc., its New York licensed captive, in its combined filing group
    - ❖ Moody's conceded premiums paid by Moody's did not qualify as deductible business expenses under Internal Revenue Code
    - ❖ It is not an insurance company for federal income tax purposes (citing *Stewart Shops*) and it is not for state purposes and thus Moody's Assurance is included in the combined group

STATE AND LOCAL TAXES – INCOME TAX

- *In the Matter of the Petition of Moody's Corporation & Subsidiaries*
  - Note: this case is an issue for
    - ❖ Any business corporation domiciled <u>anywhere</u> which does business in New York and has to pay income tax to New York State
    - ❖ Which has a captive located <u>anywhere</u>, and
    - ❖ If the captive's gross premium income is less than its other income

BASE EROSION ANTIABUSE TAX (“BEAT”)

- BEAT enacted in TRA 2017 is imposed currently at the rate of 10% [increases to 12-1/2% after 2025] on deductible payments made to foreign affiliates if:
  - Deductible payments to foreign affiliates exceed 3% of total deductible foreign payments made by the U.S. consolidated group (“Base erosion percentage”), and
  - Annual average gross receipts for the corporate group for the three previous years exceeds $500,000,000

BASE EROSION ANTIABUSE TAX ("BEAT")

- Base erosion tax payments include but are not limited to premium or other consideration paid or accrued by the taxpayer to a foreign related party for certain reinsurance payments such as:
  - Premium payments;
  - Claim payments; and
  - Other transactions between affiliates.

BASE EROSION ANTIABUSE TAX ("BEAT")

Exceptions to the definition of base erosion tax payments include:

"Any amounts paid by a taxpayer subject to tax under subchapter L to a foreign related party that is a regulated insurance company under a reinsurance contract between the taxpayer and the regulated foreign insurance company for losses incurred (as defined in section 832(b)(5)) and claims and benefits under section 805(a)(1), **to the extent that the amounts paid or accrued are properly allocable to amounts required to be paid** by the regulated foreign insurance company (or indirectly through another regulated foreign insurance company), pursuant to an insurance, annuity, or reinsurance contract, **to a person other than a related party.** For purposes of this paragraph (b)(3)(ix), the determination of whether a contract is an insurance contract or an annuity contract is made without regard to sections 72(s), 101(f), 817(h), and 7702, provided that the contract is regulated as a life insurance or annuity contract in its jurisdiction of issuance and no policyholder, insured, annuitant or beneficiary with respect to the contract is a United States person." (Treas. Reg. 1.59A-3(b)(3)(ix)(A)).

BASE EROSION ANTIABUSE TAX ("BEAT")

Base Erosion Percentage = Base Erosion Tax Benefit ÷ Total Allowable deductions*

*Including the base erosion tax benefits

BASE EROSION ANTIABUSE TAX ("BEAT")

- Claims payments are included in total allowable deductions (i.e., the denominator) when payments are made to a foreign related party.
- Claims payments by a U.S. insurer or reinsurer will not be included in the denominator if paid to a foreign unrelated entity.
- Base erosion payments are determined on a gross basis. Netting insurance transactions between related parties is not permitted unless an exception applies for U.S. federal income tax purposes.

PASSIVE FOREIGN INVESTMENT COMPANY

- In the 2017 Tax Reform Act, the law was changed with respect to the exception to passive foreign investment company ("PFIC") rules with respect to entities in the insurance industry – how does this affect offshore captives?

PASSIVE FOREIGN INVESTMENT COMPANY

- A PFIC is now defined as a foreign entity with respect to which, in general, for any taxable year either
  - It holds more than 50% of its assets for the production of passive income, or
  - More than 75% of its income is passive in nature
- If an entity is classified as a PFIC for any year, it is a PFIC with respect to any U.S. person who was a shareholder in that year – thus the phrase “once a PFIC, always a PFIC”

PASSIVE FOREIGN INVESTMENT COMPANY

- The consequence of PFIC status is that in the event of subsequent disposition of an equity interest or certain distributions total federal income tax is calculated by
  - Allocating gain/income pro rata to years shares held
  - Calculating tax on each segment at highest applicable rate
  - And calculating interest on each segment tax from year to which each segment relates to current year

PASSIVE FOREIGN INVESTMENT COMPANY

- PFIC status does not apply to 10% U.S. shareholders of a CFC, but note there is no “out” for shareholders of a RPII CFC (but there probably should be)
- PFIC status does not apply if you make one of several anti-deferral elections which, in essence, require you to pick up your share of the PFIC’s income whether or not you receive an actual distribution

PASSIVE FOREIGN INVESTMENT COMPANY

- Also, there was an exception if the foreign corporation was "in the <u>active</u> conduct of an insurance business"
  - Insurance business
  - Active conduct issues
    - ❖ Single contract
    - ❖ Small number of contracts
    - ❖ Significant number of contracts

PASSIVE FOREIGN INVESTMENT COMPANY

- Tax Reform Act added requirement of a "qualified insurance corporation", *i.e.*, liabilities (loss reserves) generally need to equal at least 25% of assets
  - No or small amount of reserves
  - Unearned premium reserve not counted
  - Accounting methods
- Alternative 10% test tied to run off or rating agency requirements
- Ability to continue to build up assets offshore

PASSIVE FOREIGN INVESTMENT COMPANY

- New proposed regulations published July 11, 2019, comments requested in 60 days
- No change with regard to exclusions for
  - Single parent captive owners
  - Group captive owners who are U.S. Shareholders as defined by the IRC if captive is a CFC
  - Group captive owners if the captive has made an election under IRC § 953(d) to be treated as domestic
  - Still no exclusion for RPII shareholder

PASSIVE FOREIGN INVESTMENT COMPANY

- REMEMBER when we say "captive" we include offshore entities that are called "captives" but might not be considered so under some domestic captive statutes, *e.g.*, a producer captive
- Three issues we need to address for the exception: (i) insurance company status,(ii) active conduct of an insurance business, and (iii) status as a qualifying insurance company

PASSIVE FOREIGN INVESTMENT COMPANY

- Insurance company status
  - For the most part, the same as before
  - Generally, more than 50% of the company's business must be writing insurance or annuity contracts or reinsuring risks underwritten by insurance companies

PASSIVE FOREIGN INVESTMENT COMPANY

- Active Conduct of Insurance Business
  - In general, a QIC actively conducts an insurance business ONLY IF the officers and employees of the QIC carry out substantial managerial and operational activities
  - The officers and employees of a QIC are considered to include officers and employees of another entity ONLY if the QIC satisfies a specified "control test"
    - ❖Owns >50% TCVP or TV (within meaning of IRC § 958(a)) or

PASSIVE FOREIGN INVESTMENT COMPANY

- Active Conduct of Insurance Business
  - …"control test"
    - ❖A common parent owns >80% of TCVP and TV of both entities within the meaning of IRC § 958(a),
    - ❖The QIC exercises oversight and supervision regularly of the other entity's officers and employees, or
    - ❖The QIC pays directly all of the compensation of the other corporation's officers and employees attributable to investment and premium income OR REIMBURSES the other entity (based on IRC § 482) OR otherwise pays arm's-length consideration, and

PASSIVE FOREIGN INVESTMENT COMPANY

- Active Conduct of Insurance Business
  - …"control test"
    - The expenses relating to officers and employees must exceed 50% of all expenses (excluding ceding commissions) paid to any person for the production or acquisition of premiums and investment income

PASSIVE FOREIGN INVESTMENT COMPANY

- Qualifying Insurance Company
  - Is an insurance company (as defined in IRC § 816(a)) subject to tax under subchapter L (see above), and
  - Meets the 25% test
    - Applicable insurance liabilities ("AIL") exceed 25% of total assets based on the company's applicable financial statement

PASSIVE FOREIGN INVESTMENT COMPANY

- Qualifying Insurance Company
  - Meets the 25% test
    - ❖But AIL limited for both this 25% test (and 10% test below). AIL may not exceed the lesser of:
      - ➢AIL shown on most recent financial statement preference for GAAP or IFRS
      - ➢Minimum amount of AIL required by the applicable law or regulation of the applicable regulatory body
      - ➢The amount shown on the most recent financial statement made on the basis of US GAAP or international financial reporting standards ("IFRS") if such statement was not prepared for financial reporting

PASSIVE FOREIGN INVESTMENT COMPANY

- Qualifying Insurance Company
  - Meets the 25% test
    - …AIL may not exceed the <u>lesser</u> of:
      - And if there is an applicable financial statement prepared under neither GAAP or IFRS and there is no discount of losses on an economically reasonable basis, the foreign corporation <u>must</u> reduce liabilities to reflect discounting that would apply under US GAAP or IFRS
    - Also if a foreign corporation was on GAAP or IFRS they cannot change to another method without a non-federal income tax reason – if they do, liabilities will be considered to be zero

PASSIVE FOREIGN INVESTMENT COMPANY

- Qualifying Insurance Company
  - Meets the 25% test
    - AIL means:
      - <u>Occurred losses</u> for which the corporation has become liable but has not paid before the end of the accounting period including unpaid claims for death benefits, annuity contracts and health insurance benefits. DOES THIS EXCLUDE RESERVES FOR IBNR?
      - Unpaid expenses of unpaid losses
      - Aggregate reserves for future, unaccrued health insurance claims, life insurance reserves and annuity reserves (excluding deficiency, contingency or unearned premium reserves). NO PROVISION FOR RESERVES FOR PROPERTY CASUALTY

PASSIVE FOREIGN INVESTMENT COMPANY

- Qualifying Insurance Company
  - Meets the 25% test
    - If you do not meet the 25% test:
      - Meet 10% test
      - Predominantly engaged in an insurance business, *i.e.*, >50% issuing insurance or annuity contracts or reinsuring risks. They are going to compare this to commercial insurers AND just because you have been holding yourself out as an insurer for a long time – does not matter
        - Facts and circumstances
        - Claim payment matters
        - Loss exposure
        - Percentage of gross receipts which are premiums

PASSIVE FOREIGN INVESTMENT COMPANY

- Qualifying Insurance Company
  - Meets the 25% test
    - If you do not meet the 25% test:
      - Predominantly engaged in an insurance business …
        - The number and size of insurance contracts taken on or through reinsurance by the foreign corporation
        - Examples of <u>not</u> predominantly in the insurance business
          - A small overall number of risks with low likelihood but large potential risks
          - Employees or agents focused to a greater degree on investment as opposed to underwriting activities
          - Low loss experience

PASSIVE FOREIGN INVESTMENT COMPANY

- Qualifying Insurance Company
  - Meets the 25% test
    - ❖ If you do not meet the 25% test:
      - ➢ Predominantly engaged in an insurance business …
        - o Failure to meet the 25% test solely due to run off related activities under it
          - * Was actively engaged in running off, terminating pre-existing liabilities under the supervision of its applicable insurance regulatory body
          - * Did not issue a contract unless obligated consistent with a plan of liquidation or termination of operations
          - * Made payments which cause the corporation to fail the 25% test

PASSIVE FOREIGN INVESTMENT COMPANY

- Qualifying Insurance Company
  - Meets the 25% test
    - If you do not meet the 25% test:
      - Predominantly engaged in an insurance business …
        - Failure to meet the 25% test because of rating related circumstances
          - * 25% test not met as a result of specific capital and surplus of a recognized credit rating agency
          - * Compliance with requirements of rating agency to maintain minimum credit rating required for the foreign corporation to be classified as secure to write new business

ECONOMIC SUBSTANCE (OECD/EU)

- Economic Substance ("ES") is an outgrowth of:
  - OECD's BEPS Initiative
    - ❖ BEPS = [Income Tax] Base Erosion & Profit-Shifting (originally aimed at largest multi-national corporations)
    - ❖ Captives specifically referenced in OECD reports as potential profit-sharing suspects
  - EU "Fair Taxation" Principle: pay tax on income where the real economic activity occurs

ECONOMIC SUBSTANCE (OECD/EU)

- Economic Substance ("ES") is an outgrowth of:
  - Current and former U.K. possessions targeted and thus have enacted EU compliant legislation to avoid black-listing
    - ❖ Overseas Territories: Bermuda, Cayman, BVI, Anguilla, Turks & Caicos
    - ❖ Crown Dependencies: Guernsey, Jersey, Isle of Man
    - ❖ Commonwealth Nations: Bahamas, Barbados

ECONOMIC SUBSTANCE (OECD/EU)

- Economic Substance ("ES") is an outgrowth of:
  - Domicile statutes enacted in haste due to black-list threat vague so still-evolving guidance notes key
    - ❖ Insurance managers' associations working with regulators to clarify application to captives
    - ❖ For example, exclusion of US owned captives electing onshore tax treatment
    - ❖ Essential that domicile presence/activities of managers be attributed to their client captive entities

ECONOMIC SUBSTANCE (USA)

- Economic Substance is a long-standing federal income tax principle
  - Courts created a common law doctrine that, in order to be considered valid and recognized, a transaction must have both:
    - A substance purpose aside from reduction of tax liability and
    - An economic effect aside from the tax impact

ECONOMIC SUBSTANCE (USA)

- Economic Substance is a long-standing federal income tax principle
  - US Supreme Court originated the judicial ES requirement in 1935 (*Gregory v. Helvering)*
    - ❖ Goal was to serve as an “anti-abuse” backstop to the statutory Internal Revenue Code (“IRC”)
    - ❖ Related judicial doctrines subsequently emerged such as “sham transaction,” “non-tax business purpose” and “step transaction”

ECONOMIC SUBSTANCE (USA)

- Economic Substance is a long-standing federal income tax principle
  - In 2010 a statutory ES was added to the IRC which includes onerous penalties
    - ❖ Key terms: Transaction must change taxpayer's economic position in a "meaningful way" and there must be a "substantial" non-tax purpose for entering into the transaction
    - ❖ Main application to the captive world is IRC Sec. 831(b) "micro-captive" formation motivation

ECONOMIC SUBSTANCE (USA)

- Economic Substance is a long-standing federal income tax principle
  - In 2010 a statutory ES was added to the IRC which includes onerous penalties
    - Recent pending US Tax Court case (*Pilot Insurance, LLC*) scheduled for trial recently raised this issue, but was settled by taxpayer's concession, thus eliminating a future written decision