

Publications

IRS “Listed Transaction” Regulations Exempt Certain Benefit Captives

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Earlier this month, the IRS published [final rules](#) that would treat certain “microcaptive” insurance transactions as “listed transactions” subject to numerous compliance requirements originally developed to combat “tax shelters.” 90 Fed. Reg. 3534 (Jan. 14, 2025). This area has long proven quite contentious between IRS and the captive insurance community ever since Notice 2016-66 (now obsolete) – an effort that was ruled invalid by the courts on procedural grounds. In 2023, the IRS issued proposed rules that were subject to a robust comment and public hearing process. The final rules reflect numerous changes from the proposed rules.

Fortunately, the final rules provide an exception for a transaction that provides insurance for employee compensation or benefits if it is covered by a Prohibited Transaction Exemption (“PTE”) issued by the Department of Labor (“DOL”) under ERISA. Thus, even if such a transaction is otherwise described in the final rule, it will not be classified as a “listed transaction.”

Over the years, the DOL has issued a series of PTEs for captives created by employers – typically to reinsure benefit risks arising under the employer’s employee welfare benefit plans (e.g., for group life, disability, and similar risks), while also allowing for deduction of the premiums as trade or business expenses. And, in July 2024, the DOL [proposed a significant PTE](#) that would allow an employer’s captive insurer to reinsure pension annuity risks.

Accordingly, employers that successfully secure PTEs for captive insurance in the future need not be concerned with the IRS’ onerous “listed transaction” rules. Even if the captive insurer makes an election under Code section 831(b) to be taxed only on its investment income – one of the requirements under the final rules and a key element of being classified as a “microcaptive” – the DOL exemption will carve it out of the listed transaction regime.

We note that the DOL PTE procedures do not require an applicant to request an exemption for transactions that are “substantially similar” to at least two individual exemptions issued in the 60-month period ending with the filing of a written

submission under the so-called “Ex-Pro” procedures. While such cases are relatively rare, they would appear to meet the requirements of the final rule.

GROOM INSIGHT: Groom lawyers have assisted numerous employers in setting up tax-efficient benefit captives. Fortunately, the IRS has not swept benefit captive arrangements into the “listed transaction” regime, as long as the employer has a PTE or the transaction meets the “substantially similar” rule above.