

July 2013

A recent court case underscores the importance of dealing with reputable service providers. (Salty Brine I, Ltd. et al v. United States of America).

The taxpayers in this case purchased Business Protection Policies (“BPP”) where the risks were covered by a life insurance policy’s separate asset accounts. The stated primary strategic goals of the transaction were:

1. Reduce business and personal income taxes
2. Reduce capital gains tax
3. Provide asset protection; and
4. Create tax-free retirement income.

The District Court found that the premiums paid were not deductible as business expenses; rather they were part of an elaborate mechanism used for the sole purpose of evading taxation. In reaching this conclusion, the court pointed to the fact that there was no meaningful difference in the taxpayers’ economic positions before and after the transaction.

As equally important, the court also concluded that the arrangement lacked all of the prerequisites of an “insurance arrangement;” namely insuring risks involving a fortuitous event, shifting of the risks to a third party or the distribution of risk amongst a number of insured.

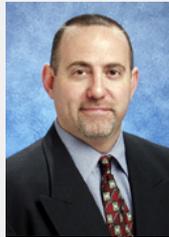
The court also focused on the relationships between the taxpayers, the sponsors of the program and various attorneys. One attorney issued an opinion letter on the viability of the program in 2001, but the attorney refused to update or reissue any subsequent opinions. One attorney that followed later withdrew his opinion due to factual misrepresentations by the sponsors. Opinions were issued by a different firm for the 2003-2005 years but the court found that those attorneys relied upon inaccurate factual representations.

In ruling against the taxpayers, the court determined that the taxpayers were liable for a 20% substantial understatement/negligence penalty, and that the reasonable cause defense to the tax shelter characterization was inapplicable.

At ERS we undertake every effort to ensure that our structures will be respected if examined by the IRS. Before entering into any arrangement, we make sure our clients have the requisite business purpose necessary to pass muster in the event of IRS scrutiny. Our entities only insure true insurance risks, and are designed to make sure that there is sufficient risk shifting and risk distribution. Finally, the premiums we charge are based upon the actual risks being insured rather than some budgeting technique.

Alan Fine is a Member in Brown Smith Wallace, LLC's Insurance and Captive Advisory Services Practice. He is a frequent contributor and speaker in the captive industry. Brown Smith Wallace works with captive insurance companies, and insurers in the property/casualty, and life and health lines, serving companies throughout the United States.

About the author



Alan J. Fine,
CPA, JD, Member - Insurance Advisory Services
314-983-1292 Direct

Brown Smith Wallace LLC
314-983-1200 Main

For more information visit: www.bswllc.com

Alan is a Member in Brown Smith Wallace's Insurance Advisory Services group, where he specializes in the taxation of insurance companies. Alan has 18 years of tax experience, working closely with insurance companies for 16 years. Prior to joining Brown Smith Wallace, Alan was a senior manager with a national accounting firm.

Disclosures

IRS Circular 230 disclosure: To ensure compliance with requirements imposed by the U.S. Internal Revenue Service, we inform you that any U.S. federal tax advice contained in this PowerPoint is not intended or written to be used, and cannot be used, for the purpose of (a) avoiding penalties under the U.S. Internal Revenue Code or (b) promoting, marketing or recommending to another party any transaction or matter addressed herein.

The views and statements expressed in this presentation are for general information only. ERS, LLC is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This presentation provides general information about certain legal and accounting issues and should not be regarded as rendering legal or accounting advice to any person or entity. As such, the information is not privileged and does not create a client relationship with the companies, or any of its employees. This presentation does not constitute an offer to represent you, and you should not act, or refrain from acting, based upon any information so provided. In addition, the information contained in this presentation is not specific to any particular case or situation and may not reflect the most current developments.