

The Economic Substance Doctrine

- In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—
 - (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and
 - (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.



What Does a “Real” Transaction Look Like?

- A real transaction
 - Originates In-House, or
 - From an ancillary consulting industry
 - Are structured to
 - Earn a profit
 - Lower costs
 - Raise Capital
 - Solve a significant problem
 - Are Open Ended

Peter C. Canellos Business Purpose, Economic Substance and Corporate Tax Shelters, 54 SMU L. Rev. 47



The Frank Lyon Factors

- In General, a Taxpayer who is a party to any transaction must be able to demonstrate:
 - there is a genuine multiple-party transaction
 - with economic substance that is
 - **compelled or encouraged by business or regulatory realities,**
 - that is imbued with tax-independent considerations, and
 - that is not shaped solely by tax-avoidance features to which meaningless labels are attached.



Pre-UPS Risk Subjective Intent

- 1.) Ocean Drilling and Exploration Co. v. United States, 24 Cl. Ct. 714, 715 (1991) (“Because of the limited experience in insuring the new rigs and a number of substantial losses on these rigs, insurance rates increased sharply”);
- 2.) Kidde Industries Inc. v. United States, 40 Fed. Cl. 42 (1977) (“In 1976, in the midst of a products liability insurance crisis in which many insurance companies either ceased or significantly restricted their coverage of products liability. . . . Travelers informed Kidde that it would not renew Kidde’s products liability insurance policy for 1977”);
- 3.) Malone and Hyde Inc. v. Commissioner, T.C. Memo. 1989-604 (“By the mid-1970s, the Hyde Insurance Agency found that insurance premiums were increasing each year and certain insurance was not obtainable for some clients”);



The Humana Decision Tree

- 1.) Going naked: not an option when several successful wrongful death claims could bankrupt the company
- 2.) Forming a reserve: rejected because there were no tax benefits
- 3.) Forming a group captive: this was rejected out of concern the other participants had financial problems
- 4.) Forming a captive: accepted and approved



Post UPS

- Non-Insurance Professions Involved
 - Estate Planning Lawyers
 - CPAs/Accounting
 - Financial Professionals
 - Series 7/Series 65



Solving the Problem

- *Who* starts the discussion and *how* do they start it?
 - Client
 - Professional
 - Make sure you devote a large percentage of the initial conversations to insurance and risk mitigation
 - Review insurance policies
 - Look at recent cases in the potential insured's industry.
 - “What keeps you up at night?”



#ACIInsurance



#ACIInsurance

