

THE TAX INSURANCE TRAP

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Conventional wisdom holds that tax uncertainty is an unavoidable consequence of our tax law’s complexity. On this view, tax insurance—a financial product allowing taxpayers to shift tax risk to an insurer for a fee—is merely a hedge against the IRS’s potential disagreement with any given tax position. With this understanding in mind, some commentators have proposed imposing restrictions on tax insurance so that the IRS, not taxpayers, can harness its full potential.

This Article offers a different account of tax uncertainty and tax insurance. It argues that persistent tax law uncertainty is not a brute fact but a policy choice. In contrast to general principles of administrative law, the Anti-Injunction Act bars pre-enforcement judicial review for taxpayers, forcing them to transact first and litigate later. Thus, while substantive complexity might create tax uncertainty, that uncertainty persists because of procedure. Viewed in this light, tax insurance functions as a synthetic pre-enforcement challenge, enabling taxpayers to resolve tax risk reliably.

This Article therefore urges caution before restricting the tax insurance market. Yet, as the industry grows, tax insurance might evolve in ways that no longer mimic pre-enforcement review. Accordingly, some policy changes are appropriate. Subject to certain conditions, this Article proposes clarifying the tax treatment of tax insurance itself, aligning it with the tax treatment of a would-be pre-enforcement challenge.

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INTRODUCTION

Most tax scholars really believe that *three* things are certain in life: death, taxes, and tax law uncertainty.¹ Citizens and residents must accept that they are taxpayers, and taxpayers must accept that they take uncertain tax positions at least some of the time. According to this line of thinking, tax uncertainty is pervasive and inescapable because our tax law touches virtually every person and business within our borders (and many outside them), leading to a dizzying maze of instructions, forms, and complex calculations.

In response to the persistence of tax law uncertainty, a new financial product—tax insurance—has developed over the last two decades,² maturing only in the last several years.³ Just like any insurance product, tax insurance enables a taxpayer to pay a fee to an insurance company in exchange for an indemnity obligation.⁴ Put differently, for the right price, a taxpayer can obtain downside protection against significant tax liabilities, which are shifted to the insurer. The primary difference

1. *But see* Letter from Benjamin Franklin to M. Le Roy (Nov. 13, 1789), in 10 JARED SPARKS, *THE WORKS OF BENJAMIN FRANKLIN* 409, 410 (1856) (stating that only two things “can be said to be certain” “in this world,” namely “death and taxes”).

2. *See* Daniel Tay, *Inflation Reduction Act Could Boost Tax Insurance Popularity*, LAW360 (Aug. 22, 2022, at 20:45 ET), <https://www.law360.com/tax-authority/articles/1522724/inflation-reduction-act-could-boost-tax-insurance-popularity> (noting that the number of bound tax insurance policies has risen from about 500 to over 6,000 between 2015 and 2021).

3. *See* Heather M. Field, *Tax Enforcement by the Private Sector: Deputizing Tax Insurers*, 99 IND. L.J. 1179, 1198–99 (2024). Although the name “tax insurance” seems to have predominated, the product has at various times also been called “tax liability insurance,” “tax opinion insurance,” “tax risk insurance,” “tax risk transactional insurance,” and “tax indemnity insurance.” *See* Kyle D. Logue, *Tax Law Uncertainty and the Role of Tax Insurance*, 25 VA. TAX REV. 339, 343 & n.3 (2005).

4. *See* Logue, *supra* note 3, at 343.

between tax insurance and a garden-variety consumer insurance contract is that a tax insurance policy indemnifies only for losses arising from a known, identified tax risk.⁵ In other words, if the Internal Revenue Service⁶ challenges (or a court rejects) the taxpayer's filing position, the insurance company will pay to the taxpayer the cost of any tax deficiency, plus penalties and interest, subject to certain limitations. Although seemingly a niche financial product, in the last several years the tax insurance market has boomed.⁷ More policies are being written, with higher limits, and these policies are increasingly enabling transactions that, absent a tax insurance policy, might be stymied by catastrophic tax risks.⁸

Tax insurance has received little scholarly treatment, and what scholarship there is rightly situates tax insurance among questions about the character of tax law uncertainty.⁹ That makes sense because, ultimately, tax insurance seeks to reduce or eliminate uncertainties with respect to a tax liability. But because this vein of scholarship generally assumes that tax uncertainty is an ineradicable feature of the tax system, it generally underappreciates the benefits that tax insurance provides and magnifies its dangers. For example, more than twenty years ago, Kyle Logue noted that tax insurance could be used by bad actors as a means by which to promote tax shelters; accordingly, Logue proposed the adoption of rules that would require taxpayers purchasing tax insurance to report that purchase to the IRS, which naturally no tax shelter promoter

5. Compare JORDAN R. PITT, STEVEN PLITT, DANIEL MALDONADO & JOSHUA D. ROGERS, *COUCH ON INSURANCE* §§ 1.34–.47 (3d ed. 2025) (describing many different kinds of insurance contracts, including general liability insurance, life insurance, family insurance, property insurance, and so on), with LOCKTON, *TAX INSURANCE: THE BASICS* (2024), <https://lockbox.lockton.com/m/4d6324bb3f88587/original/Tax-Insurance-101-2025.pdf> [<https://perma.cc/T8AX-DE5T>] (noting that “[a]n insurance company agrees to indemnify the insured for loss resulting from a tax authority’s successful challenge of a tax position” “[t]ied to a known and identified tax position”).

6. This Article hereinafter refers to the Internal Revenue Service as the “IRS” or simply “the Service.”

7. Yoav Shans, *Tax Insurance Is Ready to Launch*, 171 *TAX NOTES FED.* 35, 35 (2021); Field, *supra* note 3, at 1198.

8. Field, *supra* note 3, at 1127–28, 1198–99.

9. See, e.g., Omri Ben-Shahar & Kyle D. Logue, *Outsourcing Regulation: How Insurance Reduces Moral Hazard*, 111 *MICH. L. REV.* 197, 226 (2012) (“[T]ax liability insurance responds to costs that firms face as a result of government regulations. Here, the cost faced is the cost of uncertain tax laws.”).

could countenance.¹⁰ Discussed more fully later,¹¹ others have proposed preferential treatment for insurers who insure only strong positions,¹² mandatory tax insurance for certain types of tax positions,¹³ and even discouraging tax insurance by rehabilitating the Service's atrophied private letter ruling (PLR) program.¹⁴ In other words, the scholarship thus far has understood and critiqued tax insurance as a response to a system where tax uncertainty is ever-present and unavoidable.

This Article argues the opposite: Tax uncertainty is a policy choice, and tax insurance must be understood against that backdrop. The conventional account is correct that a tax system for a massive and complex economy like ours entails intricate systems of rules, anti-abuse standards, and tedious factual inquiries. But that cannot be the whole story: Similar legal risks exist in virtually every regulatory domain. So, what is different about tax?

The conventional view of tax uncertainty ignores the fact that Congress has affirmatively structured our tax system to limit taxpayers' ability to eliminate tax uncertainty *ex ante*. That is, taxpayers have no forum in which to ascertain the tax effect of a transaction before engaging in that transaction.¹⁵ As later explained in detail,¹⁶ the so-called Anti-Injunction Act (AIA) prohibits any court from hearing a suit that has "the purpose of restraining the assessment or collection of any tax."¹⁷ Although the purpose of the AIA is not to withhold tax certainty from taxpayers,¹⁸ the AIA in effect shuts courthouse doors to taxpayers seeking to eliminate their *ex ante* tax risk.¹⁹ This state of affairs departs markedly

10. See Logue, *supra* note 3, at 395–400 (concerns about tax shelters). Ultimately, the Service has rejected this approach, presumably on the grounds that such a reporting requirement would sufficiently increase the costs of tax insurance so as to eliminate the market for it. See Temp. Treas. Reg. § 1.6011-4T(b)(3)(i)(B) (2004) (including tax insurance policies among the category of transactions that must be affirmatively reported to the IRS).

11. See *infra* Part IV.

12. See generally Field, *supra* note 3 (proposing a "qualified insurer" program that would grant certain administrative benefits to such insurers).

13. See Michael Abramowicz, *Mandatory Tax Penalty Insurance*, 96 IND. L.J. 105, 107 (2020).

14. See William E. Foster, *Reckoning with Tax Risk*, 42 VA. TAX REV. 473, 515–16 (2023) (explaining that tax insurance might *promote* tax uncertainty by deflecting resources from the PLR program, which are effectively used as precedents by taxpayers).

15. This Article hereinafter refers to such uncertainty as "ex ante tax risk."

16. See *infra* Section I.B.

17. I.R.C. § 7421(a).

18. Generally, courts have repeated the dictum that the AIA's purpose is to permit the efficient assessment and collection of revenue without court interference, thus leaving litigation over tax liabilities to refund claims. See *infra* Sections I.B.2–3.

19. Congress has provided taxpayers a forum to challenge tax liabilities prior to payment in the Tax Court; however, the Tax Court's jurisdictional requirements imply that the underlying transaction has already occurred. See *infra* Sections I.B.2–3. As a

from general principles of administrative law, under which pre-enforcement challenges are generally available to regulated parties pursuant to the Administrative Procedure Act (APA)²⁰ and cases like *Ex parte Young*.²¹ Taxpayers, vis-à-vis other regulated parties, are therefore at a significant disadvantage in being able to eliminate regulatory risk. This Article fills a gap in the literature by explaining that, even if tax uncertainty arises because of substance, it endures because of procedure.

Tax insurance must be understood in this more textured context. In particular, tax insurance provides taxpayers the opportunity to reduce or eliminate ex ante tax risk—for a price. From the taxpayer’s perspective, then, tax insurance can be economically equivalent to a successful pre-enforcement challenge. In the former case, the taxpayer can shift the entirety of the risk associated with the tax position to the insurer through an appropriately bound insurance policy; in the latter case, the taxpayer can shift the entirety of the risk to the government. Tax insurance and pre-enforcement challenges are equivalent from the perspective of the taxpayer.²²

Because Congress has not provided another avenue for taxpayers to reckon with their ex ante tax risks, this Article concludes that policymakers should protect tax insurance, not co-opt it for administrative purposes. Overregulating tax insurance could harm the industry and thus take away the sole mechanism through which taxpayers can presently eliminate ex ante tax risk. That would put taxpayers at a double disadvantage compared to other regulated parties. And yet, the explosive growth of tax insurance suggests that a new form of tax

result, the Tax Court’s doors are, with very narrow exception, also closed to pre-enforcement challenges.

20. See 5 U.S.C. §§ 551–59. Kristin Hickman and Gerald Kerska have argued that the original meaning of the AIA is much narrower, not precluding all pre-enforcement challenges of IRS actions but instead requiring a “tighter temporal connection between the AIA and the assessment and collection functions that Congress anticipated when it enacted the AIA.” Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 VA. L. REV. 1683, 1748–49 (2017); see also Daniel J. Hemel, *The Living Anti-Injunction Act*, 104 VA. L. REV. ONLINE 74, 79 (2018), <https://virginialawreview.org/articles/living-anti-injunction-act/> [https://perma.cc/LYB8-TT3L] (discussing pre-enforcement challenges and the AIA). Whether or not that test is correct, as a descriptive matter, courts have interpreted the AIA broadly, see *infra* Section I.B.2, and as even Hickman and Kerska concede, courts are eager to dispose of tax cases on AIA grounds because they often present courts with “the narrowest ground for resolving otherwise messy cases,” Hickman & Kerska, *supra*, at 1748.

21. 209 U.S. 123 (1908).

22. This is not to say, of course, that tax insurance and pre-enforcement challenges are economically equivalent in all respects. Certainly, the IRS should prefer tax insurance: In the case of a successful pre-enforcement challenge, all the downside of uncertain tax laws has accrued to the government because it receives no influx of revenue. Insurers would prefer the opposite: When a tax policy is bound and the IRS successfully challenges the covered filing position, the insurance company bears the downside.

insurance may be on the horizon: general tax liability insurance. This type of insurance would insure *any* tax liability, not a single issue (or cluster of issues). In that respect, general tax liability insurance does not constitute a synthetic pre-enforcement challenge.

How can policymakers get out of this tax insurance trap? Should they leave tax insurance well enough alone, worrying that any government intervention could harm the market? If not, what reforms are appropriate? This Article argues that Congress and the Service should promote tax insurance by, funny enough, clarifying its tax treatment. To wit, (1) tax insurance premiums should be treated as deductible business expenses, and (2) proceeds from the recovery of tax insurance should be excludable (to the extent not already excludable under current law) from gross income.²³ Not only would these reforms promote tax insurance by making it less expensive, but this tax treatment is also warranted because it parallels the tax treatment of a regulated party that successfully files a pre-enforcement challenge. Favorable tax treatment could be limited to certain kinds of policies, for example, policies that do not insure tax shelters or reportable transactions and policies that are economically equivalent to pre-enforcement challenges. Such an approach would help bring taxpayers back into parity with general principles of administrative law.

This Article proceeds as follows. Part I begins by recounting the “classical” story of tax law uncertainty, according to which ex ante tax risks arise solely from the Internal Revenue Code’s²⁴ complexity, the difficulty of computing tax based on many varied facts, and our tax law’s use of anti-abuse standards.²⁵ Part I challenges that story and explains that taxpayers are left in a state of ex ante tax risk because Congress has made it so by way of the AIA.²⁶ Part II discusses the “old market” for products and arrangements that assist taxpayers in addressing ex ante tax risk—advisor and preparer warranties, tax opinions, tax indemnities, and PLRs—concluding that each is insufficient.²⁷ Part III turns to tax insurance, describing how it works and arguing for the view that tax insurance provides taxpayers a kind of synthetic pre-enforcement

23. This treatment has also been advocated for by Jeffrey Kahn and Ken Brewer, although on a different basis. See Jeffrey H. Kahn, *Hedging the IRS: A Policy Justification for Excluding Liability and Insurance Proceeds*, 26 YALE J. ON REGUL. 1, 24 (2009); Ken Brewer, *Tax Risk Insurance: Another View on the Proper Tax Treatment*, 170 TAX NOTES FED. 1087, 1095–96 (2021).

24. Hereinafter, the as-amended Internal Revenue Code is referred to as the “IRC” or simply the “Code.” References to a “section” or “§” is a reference to the Code or the Treasury Regulations, as the context requires.

25. See *infra* Section I.A.

26. See *infra* Section I.B.

27. See *infra* Part II.

challenge.²⁸ Part III also details the explosive growth of the tax insurance market in the last several years, why it has grown, and whether tax insurance could drift away from a synthetic pre-enforcement challenge toward general tax insurance.²⁹ Part IV addresses the future of tax insurance, arguing that making tax insurance mandatory or co-opting tax insurers would significantly disadvantage taxpayers.³⁰ Instead, a more modest approach—clarifying the tax treatment of tax insurance—would preserve taxpayers’ ability to combat ex ante tax risk via insurance and also would accord with insurance’s equivalency to pre-enforcement challenges.³¹

I. THE ORIGINS OF TAX LAW UNCERTAINTY

According to one account of tax law uncertainty—referred to here as the classical story of tax law uncertainty—tax risks arise from the familiar dichotomy between “rules” and “standards.” Because federal tax law touches virtually every transaction, the Code is an onerous web of rules and anti-abuse standards. Consequently, even sophisticated practitioners cannot provide too much certainty about the tax treatment of many transactions.

True as the classical story of tax law uncertainty may be, it ignores an important source of tax law risk: that pre-enforcement challenges are unavailable to taxpayers. When regulated parties face legal uncertainty about behavior they wish to engage in, general principles of administrative law permit them to file a suit in court seeking a declaration or injunction. If the regulated party loses, it will not have acted in an unlawful way and will face no costs other than those of litigation. But such pre-enforcement challenges are not available to taxpayers as such. Our tax system provides no forum in which a taxpayer can hope to resolve tax uncertainties prior to engaging in an action that might generate a tax liability. In other words, taxpayers are unable to achieve legal certainty ex ante; they transact at their own peril.³² This Part details the classical story of tax law uncertainty and then develops the connection between the unavailability of pre-enforcement challenges in the tax domain and tax law risk, a connection which has gone unrecognized in the literature.

28. See *infra* Sections III.A–B.

29. See *infra* Section III.C.

30. See *infra* Section IV.A.

31. See *infra* Section IV.B.

32. Several mechanisms have developed to take the edge off these risks; however, each mechanism is imperfect and frequently leaves taxpayers subject to unhedged risks. See *infra* Part II.

A. The “Classical” Story of Tax Law Uncertainty

Scholars have long observed that legal uncertainties abound in our tax law, and in so observing, they have told a familiar story. This classical story goes something like the following.³³ All legal frameworks—not just tax frameworks—are made up of two types of principles: rules and standards.³⁴ Generally speaking, rules are precise and direct behavior.³⁵ For example, a rule might prohibit driving a car on a public street at a speed greater than twenty-five miles per hour.³⁶ Rules provide clear guidance both to regulated parties as well as to those charged with enforcing the rules, thus providing a substantial amount of confidence *ex ante* about the application of the law after the fact.³⁷ Standards, by contrast, are more flexible, employing general principles, the application of which often turns on a constellation of discrete facts or the relationship between those facts—and which can only be evaluated after the fact.³⁸ For example, a standard might prohibit driving a car on a public thoroughfare at an unreasonable speed. The upside of standards is that standards minimize costs to drafters of legal frameworks and allow legal results to be tailored to the circumstances.³⁹ However, standards impose costs by creating legal uncertainty *ex ante*. Different decision-makers will weigh competing considerations differently. Standards are thus helpful tools in crafting anti-abuse doctrines.

33. For an account that largely tracks the classical story, see Logue, *supra* note 3, at 349–72, and Foster, *supra* note 14, at 479–81 (describing several complexities in our nation’s tax laws, especially the “gaps” that “arise from a regime that relies on both standards and rules”).

34. The scholarship on the difference between rules and standards is seemingly limitless. *See generally* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 559 & n.1 (1992) (collecting sources); Russell B. Korobkin, *Behavioral Analysis and Legal Form: Rules vs. Standards Revisited*, 79 OR. L. REV. 23 (2000) (analyzing rules and standards on both legal and economic grounds). *But see* Kevin M. Clermont, *Rules, Standards, and Such*, 68 BUFF. L. REV. 751, 758 (2020) (arguing that the distinction between rules and standards is in fact “rather vague”).

35. *See* Kaplow, *supra* note 34, at 559–60 (stipulating that a rule involves “an advance determination of what conduct is permissible, leaving only factual issues for the adjudicator”); *see also* Pierre Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 381–84 (1985) (“Rules draw a sharp line between forbidden and permissible conduct . . .”).

36. *See* Kaplow, *supra* note 34, at 560.

37. Schlag, *supra* note 35, at 384–86 (describing the upside of having rules with respect to deterrence and delegation).

38. Clermont, *supra* note 34, at 758 (“A standard guides decision by giving some explicit or implicit formula of considerations, with the decisional law being given most of its content during its application.”); Anthony J. Casey & Anthony Niblett, *The Death of Rules and Standards*, 92 IND. L.J. 1401, 1403 (2017).

39. *See* Casey & Niblett, *supra* note 38, at 1403 (describing standards as “avoid[ing] high up-front design costs”).

American tax law has been called, for good reason, “the paradigmatic system of rules.”⁴⁰ Print versions of the Code and accompanying Treasury Regulations stretch many thousands of pages;⁴¹ you would not want to carry them around in your backpack. This tabulation does not consider the various categories of administrative guidance—some with the force of law, others without—that construe and modify the Code and Treasury Regulations.⁴² Although the rules contained in these varied authorities are complex, their application to routine financial transactions typically leads to clear tax treatment and ascertainable tax liabilities. For example, consider a U.S. citizen who sells a share of corporate stock, which was held for longer than a year and was sold at a gain. The holder will recognize long-term capital gain on the sale and pay tax at preferential rates; in the ordinary case—which transpires billions of times per day in the public equity markets—this treatment is very clear.⁴³ Whatever certainty there is in our tax laws arises from the application of basic rules like these to mundane, routine transactions.

However, attempting to address every situation with a legal rule introduces a kind of legal risk, which we might call “complexity.” As rules accumulate in number, questions arise as to the relationships between the rules. Even regulated parties acting in good faith can have difficulty complying. While the example in the immediately prior paragraph is relatively straightforward (a U.S. citizen selling marketable stock at a gain after one year), there are exceptions to this rule that are not altogether rare. What if, for example, the U.S. shareholder described above is selling a share in a publicly traded non-U.S. company? In determining the treatment of the sale (including whether it qualifies for an advantageous tax rate), the shareholder will need to determine whether the company is a passive foreign investment company (known universally

40. David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 860 (1999).

41. For example, Wolters Kluwer’s compendium of the Code published in the summer of 2024 is spread across two volumes and approximately 4,100 pages. See WOLTERS KLUWER, INTERNAL REVENUE CODE: AS OF MAY 31, 2024 (2024). The same publisher’s mammoth set of Treasury Regulations promulgated under the Code stretches to over 14,000 pages. See WOLTERS KLUWER, INCOME TAX REGULATIONS: INCLUDING PROPOSED REGULATIONS (2024).

42. See *Understanding IRS Guidance - A Brief Primer*, IRS, <https://www.irs.gov/newsroom/understanding-irs-guidance-a-brief-primer> [<https://perma.cc/HF6K-WCUZ>] (last visited Mar. 15, 2026) (listing other categories of administrative guidance such as revenue rulings, revenue proceedings, private letter rulings, and technical advice memoranda).

43. See I.R.C. § 1001(a) (“The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain”); *id.* § 1221 (defining capital asset).

to practitioners as a “PFIC”).⁴⁴ If the company is a PFIC, and the holder has not filed certain elections with the IRS,⁴⁵ then a shareholder’s gain upon sale will be taxed at ordinary rates and, *horribile dictu*, spread out ratably over the holder’s holding period, thus resulting in an additional interest charge.⁴⁶ If the company is not a PFIC, still other rules from the Code might apply that could benefit the taxpayer, effectively deferring tax. For example, if the taxpayer receives as consideration certain property other than cash, she might not recognize gain at all (and thus pay no immediate tax).⁴⁷ In other words, complexity increases the possibility that an exception or modification of the basic rule must be considered.

As rules proliferate, they introduce another type of risk, which we might call “factual uncertainty.” When more and more rules become relevant to the determination of a tax question, then generally speaking more and more facts become relevant to that determination as well. That is because each incremental rule will, more often than not, introduce facts that other applicable rules may not have taken into account. Factual uncertainty poses three issues for taxpayers. The facts underlying a tax determination might themselves be uncertain, and as more and more facts become relevant, it is possible that a fact critical to the determination might be indeterminable. In addition, the number of facts requisite to make a well-rounded determination might be so vast that the taxpayer cannot reasonably expend the resources to gather all such facts. Finally, it is possible that certain facts essential to determining the overarching legal question are simply unavailable to the taxpayer.

The PFIC regime provides a useful example of all three types of factual uncertainty. Generally, a non-U.S. company will be treated as a PFIC for a taxable year if either a certain percentage of its income is “passive” income or a certain percentage of its assets are the sort of assets that are held for the production of “passive” income,⁴⁸ as well as

44. See *id.* § 1297(a) (defining PFIC).

45. See *id.* § 1294 (qualified electing fund election); *id.* § 1296 (mark-to-market election for marketable stock).

46. *Id.* § 1291(a)(1) (providing that “excess distribution[s]” from PFICs are “allocated ratably to each day in the taxpayer’s holding period” and charging thereon a “deferred tax amount”); *id.* § 1291(a)(2) (providing that dispositions of stock in a PFIC are treated similarly to excess distributions).

47. See *id.* § 354(a)(1) (providing for nonrecognition treatment if the taxpayer receives “stock or securities in . . . another corporation a party to the reorganization”); see also *id.* § 368(a) (defining “reorganization”).

48. Generally, a PFIC is any foreign corporation for which, with respect to the taxable year in question, either (1) 75 percent or more of its income is “passive income,” or (2) 50 percent or more of its assets (by value) are assets that are held for the production of “passive income.” *Id.* § 1297(a).

whether a host of exceptions apply.⁴⁹ First, one critical determination is whether a foreign company's goodwill—which is an asset of the company—is held for the production of passive or active income.⁵⁰ In many cases, the allocation of a company's goodwill between the active and passive categories of assets could make all the difference in whether the company is a PFIC, yet drawing the line as a factual matter is virtually impossible to do. Second, because the PFIC test requires looking at all of the company's income and assets and assessing whether they are active or passive, the number of facts required to determine whether a company is a PFIC can be astronomical. Indeed, every asset is relevant to making this determination.⁵¹ Third, and perhaps most importantly, many shareholders of foreign companies simply may not have access to the information required to determine whether the company is a PFIC—that is, current income statements and asset tables of the company. What this means is that, as a factual matter, taxpayers simply must make an educated guess as to whether they hold shares in a PFIC.

The Code's intricacy is not all bad news for taxpayers. Adding rules to the Code or Treasury Regulations can have unintended consequences—such as shifting taxpayer incentives or interacting in an unanticipated manner with other provisions of the tax law. This means that dedicated taxpayers (or those with sophisticated advisors) sometimes identify “loopholes” or other inconsistencies and use them to reduce their tax bill. Of course, not all loopholes are created equal, with some being accepted as typical, ethical means of reducing one's tax liability and others being viewed as fraudulent tax shelters. Wherever one draws the line,

49. For example, the PFIC rules contain special rules—although not all are easy to apply—for foreign banks, insurance companies, related parties, and export trade corporations. *See id.* § 1297(b)(2). Generally, the exceptions operate by treating certain income items and assets as active that, with respect to an ordinary business, would have been treated as passive. Even if an exception applies with respect to a particular tax year, a company is generally treated as a PFIC with respect to a U.S. investor, provided that the company was a PFIC with respect to any taxable year that overlaps with the investor's holding period. *See id.* § 1298(b)(1).

50. *See* I.R.S. Notice 88-22, 1988-1 C.B. 489 (“Goodwill or going concern value must be identified with a specific income-producing activity of the corporation and characterized as a passive or nonpassive asset based on the income derived from the activity.”); Guidance on Passive Foreign Investment Companies and the Treatment of Qualified Improvement Property under the Alternative Depreciation System for Purposes of Sections 250(b) and 951A(d), 86 Fed. Reg. 4582, 4587–88 (Jan. 15, 2021).

51. *See* Charles A. Barragato, *Cleansing the PFIC Taint: Planning and Pitfalls*, TAX ADVISER (June 1, 2017), <https://www.thetaxadviser.com/issues/2017/jun/cleansing-pfic-taint-planning-pitfalls/> [<https://perma.cc/C35F-KACV>] (stating that the PFIC rules “have created complexity and myriad pitfalls for the unwary investor and tax professional”); N.Y. STATE BAR ASS'N TAX SECTION, REP. NO. 994, PROPOSALS FOR GUIDANCE WITH RESPECT TO PASSIVE FOREIGN INVESTMENT COMPANIES 5–6 (2001) (“[W]here the foreign corporation is engaged in an active business, U.S. investors and the officers of the foreign corporation may *never realize* that the PFIC rules—which were intended to target passive investments—might, technically, apply.”).

Congress, the IRS, and courts are, of course, aware of this effect, and the response across the board has been to institute anti-abuse frameworks to frustrate the designs of creative taxpayers.⁵² These anti-abuse frameworks typically take the form of a facts-and-circumstances test, which is to say that they deploy standards (as opposed to rules) against taxpayers.⁵³ The most significant anti-abuse standard in American tax law—the economic substance doctrine—first arose as a judicially created doctrine⁵⁴ and then was enacted by Congress in 2010.⁵⁵ It stipulates, essentially, that a tax benefit will not be sustained by the Service or a court where the transaction giving rise to the tax benefit does nothing (or very little) to alter the parties’ economic circumstances.⁵⁶ While the economic substance doctrine is an overarching anti-abuse framework in federal income tax law, countless subareas of the law employ their own specific anti-abuse standards.⁵⁷ This is another source of tax law risk: the frequent use of anti-abuse standards in the tax law, which are highly fact dependent and apply only on an ex-post basis. Taxpayers considering a transaction that implicates an anti-abuse provision can only rarely conclude with confidence how the transaction will be treated by the IRS or a court.

The classical story of tax law uncertainty is a story of rules and standards. Because the tax law touches virtually all transactions, the Code and Treasury Regulations comprise a vast field of rules, whose interaction and manifold factual inquiries can make any taxpayer dizzy. And because so much rides on minimizing tax expense, clever taxpayers and their advisors are often on the hunt for new ways to exploit the interactions between this expansive set of rules. As a result, many transactions implicate the Code’s standards-based provisions, which inject a final layer of uncertainty in the quest to ascertain the proper tax treatment.

52. But see David Elkins, *Rules, Standards, and the Value of Certainty in Tax Law*, 22 BERKELEY BUS. L.J. 40, 43–45 (2025) (arguing that standards are ineffective and harmful in the field of taxation).

53. See generally Emily Cauble, *Administering Facts-and-Circumstances-Based Tax Tests*, 76 BAYLOR L. REV. 249 (2024) (describing the difficulty of administering, enforcing, and providing guidance on facts-and-circumstances-based tests).

54. See *Gregory v. Helvering*, 293 U.S. 465, 470 (1935).

55. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111–152, § 1409, 124 Stat. 1029, 1067–68; I.R.C. § 7701(o).

56. See *Gregory*, 293 U.S. at 469–70 (disregarding the form of the transaction because it was “nothing more than a contrivance”).

57. See, e.g., Treas. Reg. § 1.701-2(a)(1)–(2) (providing that subchapter K’s partnership rules apply only to “bona fide” partnerships, transactions entered into must be “for a substantial business purpose,” and that generally any partnership transaction “must be respected under substance over form principles”).

B. Pre-Enforcement Challenges and Ex Ante Tax Risk

The classical story of tax law uncertainty explains why uncertainty arises in our tax law, but it does not explain why that uncertainty persists. Unaddressed by the story is why taxpayers often seem stuck in legal purgatory, without an opportunity to resolve the tax risk one way or the other. The remainder of this Part completes the classical story of tax law uncertainty by describing the general prohibition on pre-enforcement challenges to the assessment and collection of federal taxes in federal courts. In other words, a taxpayer contemplating a transaction that raises significant tax risks—whether the risks arise from the complicated interaction of manifold rules, factual uncertainties, or the application of anti-abuse standards—has no forum in which to resolve these risks prior to engaging in the transaction. That taxpayer must stomach the risk or abandon the transaction. That is because Congress has proactively chosen to shut courthouse doors to taxpayers via the so-called Anti-Injunction Act.

1. Pre-Enforcement Challenges

Longstanding principles of administrative law permit, in the ordinary case, a regulated party to challenge agency action prior to enforcement. In *Abbott Laboratories v. Gardner* (*Abbott Labs*),⁵⁸ the Supreme Court explained that the APA “embodies the basic presumption of judicial review” for parties suffering adverse consequences as a result of agency action.⁵⁹ The primary requirement for claiming judicial review under *Abbott Labs* is that the challenged action rise to the level of a “final agency action,”⁶⁰ meaning that the action marks the “‘consummation’ of the agency’s decisionmaking process” and is an action “from which ‘legal consequences will flow.’”⁶¹ Because the promulgation of final rules after notice-and-comment rulemaking (among other forms of agency action) usually rise to the level of “final agency action,” the rule under *Abbott Labs* generally permits regulated parties to sue agencies prior to the initiation of an enforcement action against them. The *Abbott Labs* court subjected this rule to only a few limitations, namely that the agency action in question must not be one committed by law to agency

58. 387 U.S. 136 (1967).

59. *Id.* at 140.

60. 5 U.S.C. § 704.

61. *Bennett v. Spear*, 520 U.S. 154, 177–78 (1997) (first quoting *Chicago & S. Air Lines, Inc. v. Waterman S.S. Corp.*, 333 U.S. 103, 113 (1948); and then quoting *Port of Bos. Marine Terminal Ass’n v. Rederiaktiebolaget Transatlantic*, 400 U.S. 62, 71 (1970)).

discretion,⁶² and there must be no other statute that forecloses or otherwise modifies judicial review by clear and convincing evidence.⁶³ Generally speaking, plaintiffs with a cause of action under the APA can seek non-monetary relief, such as an injunction or a declaration.⁶⁴

Over time, other doctrinal developments have expanded the availability of pre-enforcement challenges under *Abbott Labs*. In a line of cases beginning with *Ass'n of Data Processing Service Organizations, Inc. v. Camp*,⁶⁵ the Court made it easier for plaintiffs claiming harm from administrative action to sue in court. *Data Processing* held—or was read to have held⁶⁶—that a plaintiff has a cause of action under the APA against an agency if she has constitutional standing and “is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee” allegedly abridged by the agency.⁶⁷ In other words, to claim a cause of action under the APA, a plaintiff need not establish that the final agency action caused “legal wrong” to the plaintiff or that the plaintiff was otherwise “adversely affected or aggrieved” within the meaning of the APA.⁶⁸ In addition, the Court recently enabled plaintiffs to avail themselves of the APA’s cause of action against an agency even long after the agency has promulgated a final rule. In *Corner Post, Inc. v. Board of Governors of Federal Reserve System*,⁶⁹ the Court held that the statute of limitations applicable to APA claims only begins to run when the regulated party “suffers an injury.”⁷⁰ In so holding, the

62. The Court would later elucidate the meaning of “committed to agency discretion by law” in *Heckler v. Chaney*, 470 U.S. 821, 826 (1985).

63. *Abbott Lab's*, 387 U.S. at 140–41.

64. See 5 U.S.C. § 702; *Skelly Oil Co. v. Phillips Petroleum Co.*, 339 U.S. 667, 671–72 (1950) (clarifying that the Declaratory Judgment Act does not provide an independent jurisdictional basis because it does not supply a cause of action).

65. 397 U.S. 150 (1970).

66. Caleb Nelson has persuasively argued that *Data Processing* did not actually hold that the APA confers a cause of action on any party whose interests are only “arguably” within the zone of interests protected by the underlying statute. Caleb Nelson, “*Standing*” and Remedial Rights in Administrative Law, 105 VA. L. REV. 703, 703–04 (2019). Notwithstanding Nelson’s strong arguments, the supposed misreading of *Data Processing* has been repeated by the Court and remains the applicable legal standard. See *Match-E-Be-Nash-She-Wish Band of Potawatomi Indians v. Patchak*, 567 U.S. 209, 225 (2012) (applying the *Data Processing* test and noting that the test “forecloses suit only when a plaintiff’s ‘interests are so marginally related to or inconsistent with the purposes implicit in the statute that it cannot reasonably be assumed that Congress intended to permit the suit’” (quoting *Clarke v. Sec. Indus. Ass'n*, 479 U.S. 388, 399 (1987))); *Lexmark Int'l Inc. v. Static Control Components, Inc.*, 572 U.S. 118, 129 (2014) (describing the *Data Processing* test as the “limitation on the cause of action for judicial review conferred by” the APA).

67. *Data Processing*, 397 U.S. at 152–53.

68. 5 U.S.C. § 702.

69. 144 S. Ct. 2440 (2024).

70. *Id.* at 2444.

Court rejected the government's position that the statute of limitations begins to run when the agency's action becomes final—such as upon the promulgation of a final regulation—with Justice Brett Kavanaugh noting that such a rule “would *de facto* overrule *Abbott Laboratories*.”⁷¹ Thus, regulated parties can file *Abbott Labs*-type claims long after agencies have acted, provided that the regulated party's injury (or impending injury) is sufficiently proximate to the filing of the complaint. With doctrinal developments like these favoring plaintiffs, pre-enforcement challenges under the APA have become an indispensable tool for regulated parties to challenge administrative action.

Over and apart from the APA, regulated parties have also traditionally possessed a cause of action in equity to restrain unlawful administrative action. At least since *Ex parte Young*, regulated parties have typically possessed a right to sue a government official in equity for the purpose of restraining that officer from bringing a proceeding at law against the regulated party—that is, against enforcing a regulation or order against the regulated party.⁷² The crux of the suit, as in an APA suit, was whether the imminent enforcement action was compliant with the controlling statute and the Constitution. As with any suit in equity, the chief limitation on bringing an *Ex parte Young* action against an officer was that the plaintiff establish the unavailability of a remedy at law.⁷³ But, at least to the extent relevant here, in many cases that requirement could be satisfied by showing that “severe penalties” could attach to a legal violation.⁷⁴

Each of these methods of challenging administrative action in advance—pre-enforcement APA suits and *Ex parte Young* challenges—could in principle be available to taxpayers.⁷⁵ There may be some reasons to treat taxpayers differently from other regulated parties in the first

71. *Id.* at 2468 (Kavanaugh, J., concurring).

72. As Nelson points out, this cause of action has always been available to a narrower class of plaintiffs than has been the APA (at least as understood by most interpreters of *Data Processing*), because an *Ex parte Young* claim could only be brought by “direct targets of regulation—the individuals or entities who would have been defendants in the enforcement proceeding that they were asking the court to enjoin.” Nelson, *supra* note 66, at 715.

73. See Doug Rendleman, *The Inadequate Remedy at Law Prerequisite for an Injunction*, 33 FLA. L. REV. 346, 346 (1981) (citing *Boyce v. Grundy*, 28 U.S. (3 Pet.) 210 (1830)); see also *Winter v. Nat. Res. Def. Council, Inc.*, 555 U.S. 7, 9, 20–22, 54 (2008) (restating that, to win an injunction, the plaintiff must establish that irreparable harm is not simply “possible” but also “likely”).

74. *Stafford v. Wallace*, 258 U.S. 495, 512 (1922).

75. This assumes that other obstacles to obtaining judicial review of administrative action, such as sovereign immunity, do not foreclose such review.

instance,⁷⁶ but the Court has expressed the view that it is “not inclined to carve out an approach to administrative review good for tax law only.”⁷⁷ In the same way that *Abbott Labs* and the APA generally do not require a regulated party to act at their peril, they so too might permit a taxpayer to file a pre-enforcement challenge prior to engaging in a transaction that could increase the taxpayer’s tax liability. In addition, there is no reason in principle why *Ex parte Young*-type claims should be unavailable to taxpayers. Provided that the taxpayer can establish that the tax would produce an irreparable harm—which is not always possible in the particular case but is made more likely under cases like *Stafford v. Wallace*⁷⁸—the taxpayer could in theory obtain an injunction against enforcement. Indeed, such suits have a long history in our country, even pre-dating *Ex parte Young*. As noted by John Harrison,⁷⁹ in the seminal case *Osborn v. Bank of the United States*,⁸⁰ the Court affirmed an injunction against Ralph Osborn, an Ohio official who sought to collect a tax from the Bank of the United States, which had been held unconstitutional in *M’Culloch v. Maryland*.⁸¹

Under general principles of administrative law, then, pre-enforcement challenges to acts of regulation and government enforcement are typically available to regulated parties. There is little reason to think—at least in principle—that taxpayers are treated differently under those general principles. Provided that a taxpayer plaintiff can establish the other elements required to succeed on their pre-

76. See generally David A. Weisbach, *Against Anti-Tax Exceptionalism*, 77 TAX L. REV. 1 (2024) (presenting reasons why taxation should be treated differently from other regulatory domains).

77. *Mayo Found. for Med. Educ. & Rsch. v. United States*, 562 U.S. 44, 55 (2011); see also *Dickinson v. Zurko*, 527 U.S. 150, 154 (1999) (“[r]ecognizing the importance of maintaining a uniform approach to judicial review of administrative action”); cf. *Skinner v. Mid-America Pipeline Co.*, 490 U.S. 212, 222–23 (1989) (rejecting “a different and stricter nondelegation doctrine” for delegations under Congress’s taxing authority); *FCC v. Consumers’ Rsch.*, 145 S. Ct. 2482, 2497–98 (2025) (citing *Skinner* and *J. W. Hampton, Jr. & Co. v. United States*, 276 U.S. 394 (1928)) (“Twice before, we have rejected a party’s request to create a special nondelegation rule for revenue-raising legislation.”).

78. 258 U.S. 495 (1922).

79. John Harrison, *Ex Parte Young*, 60 STAN. L. REV. 989, 996–97 (2008).

80. 22 U.S. (9 Wheat.) 738 (1824). This principle was also stated in dicta in *In re Ayers*, 123 U.S. 443 (1887), which held that a suit to restrain the collection of a state tax was foreclosed on the ground of sovereign immunity. *Id.* at 462, 486–87. In so holding, the Court explained that “[i]f the court had power . . . to entertain the suit for that purpose, it had equal power . . . to grant the restraining order” preventing the commencement of suits, that is, that collection of the tax could be enjoined. *Id.* at 487. That *Osborn* and *Ayers* concerned restraints against state taxation is likely of little moment given that *Ex parte Young* also concerned an injunction against a state official.

81. 17 U.S. (4 Wheat.) 316 (1819).

enforcement claim, such claims typically ought to be available to taxpayers as such.

2. The Anti-Injunction Act

By statute, however, Congress has chosen a different policy path. Under the AIA, “no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person.”⁸² By depriving federal courts of subject matter jurisdiction over cases to which the AIA applies,⁸³ the AIA creates a tax system wherein tax uncertainty can be challenged only after the fact, by means of a refund suit or a pre-assessment petition in the Tax Court. As a result, the AIA necessarily makes pre-enforcement challenges unavailable to taxpayers as a general matter.⁸⁴

Application of the AIA raises three distinct inquiries, but none are particularly difficult for the IRS to satisfy, meaning the AIA’s jurisdictional bar is far-reaching. Those three inquiries are (1) whether there is a “suit,” (2) whether the charge that is the subject of the suit constitutes a “tax,” and (3) finally whether the suit has the “purpose of restraining the assessment or collection” that tax.

The “suit” prong has the effect of requiring that the government be styled as the defendant in the action. Because a suit denotes a proceeding “instituted for the purpose of enforcing a right or otherwise seeking justice,”⁸⁵ the AIA applies only if there is a complete action, the aim of which is restraining the assessment or collection of a tax. Obviously, the IRS does not bring actions to restrain taxes, so the AIA would not apply to a suit brought by the government. And even when the government does institute a suit against a taxpayer, for collection or otherwise, courts have held that the AIA does not bar the taxpayer from litigating against the government in the ordinary course, even if doing so would result in an order against the government. For example, the Eleventh Circuit has

82. I.R.C. § 7421(a). The AIA was first enacted in 1867. *See* Tax Anti-Injunction Act, Pub L. 39-169, § 10, 14 Stat. 471, 475 (Mar. 2, 1867).

83. *See, e.g., Bob Jones Univ. v. Simon*, 416 U.S. 725, 749 (1974) (applying the AIA and concluding that the lower courts “did not err in holding that § 7421(a) deprived the District Court of jurisdiction”); *In re Walter Energy, Inc.*, 911 F.3d 1121, 1136 (11th Cir. 2018). *But see Harper v. Rettig*, 46 F.4th 1, 8 (1st Cir. 2022) (describing how the AIA “is not an applicable exception to the United States’ waiver of sovereign immunity in 5 U.S.C § 702” of the APA). In addition, pursuant to the so-called “*Mansfield Rule*,” *see Mansfield v. Swan*, 111 U.S. 379 (1884), no waiver applies if the issue is not raised, and the court is required to raise the AIA *sua sponte*.

84. *See Hickman & Kerska, supra* note 20, at 1685 (describing the AIA as an “exception[]” to “the *Abbott Labs* presumption of reviewability for final agency action”).

85. BRYAN A. GARNER, GARNER’S DICTIONARY OF LEGAL USAGE 862 (3d ed. 2011).

held that a taxpayer's motion for a protective order in a case brought by the government is not a "suit" and therefore is not barred by the AIA.⁸⁶

There remains some debate about what government charges constitute a "tax" for purposes of the AIA, but the test, as one would expect, turns on congressional intent. In *NFIB v. Sebelius*,⁸⁷ the Court summarized its precedents as standing for the proposition that the "text of the pertinent statute" controls.⁸⁸ If Congress specifically labels a levy as a "tax"—even if its substance is not to raise revenue—then the AIA bars an injunction to restrain the levy.⁸⁹ The reverse is also true: *NFIB* noted that Congress had termed the shared-responsibility payment a "penalty" rather than a "tax," and thus the AIA did not apply to the suit.⁹⁰ Furthermore, in determining whether a levy is a "tax" for purposes of the AIA, it is irrelevant whether the levy is a tax for constitutional purposes as well as how the government collects the levy.⁹¹ The inquiry often begins and ends with the moniker Congress bestows upon the levy.⁹² As a result, most levies imposed by the Code fall within the scope of the AIA.

The remaining prong of the AIA—that the suit has "the purpose of restraining the assessment or collection of [a] tax"⁹³—is the most interesting prong, but it also is not particularly difficult to meet. Although the prong uses the term "purpose," the test does not look to the intent of the taxpayer in filing the suit—that is, what benefit does the plaintiff subjectively seek⁹⁴—but rather to the formal legal remedy available. When the relief sought is an injunction (or a declaration)⁹⁵ and the order

86. See *United States v. Meyer*, 50 F.4th 23, 28 (11th Cir. 2022); see also *United States v. Mellon Bank, N.A.*, 521 F.2d 708, 711 (3d Cir. 1975) (motion by taxpayer to intervene in suit between IRS and bank not barred by the AIA because the taxpayer "filed no suit at all"); *United States v. First Nat'l City Bank*, 568 F.2d 853, 856 (2d Cir. 1977) (holding that the AIA "has no application to counterclaims or defenses interposed by a taxpayer in an action brought by the government").

87. 567 U.S. 519 (2012).

88. *Id.* at 543.

89. *Id.*

90. *Id.* at 544. Of course, many provisions of the Code are called "penalties" rather than "taxes." But as the Court noted in *NFIB*, § 6671(a) provides that references to "penalties" in certain areas of the Code are treated as taxes for purposes of other Code provisions and thus would fall within the scope of the AIA. *Id.* at 544–45.

91. *Id.*

92. See *Optimal Wireless LLC v. IRS*, 77 F.4th 1069, 1074 (D.C. Cir. 2023) ("The multiple statutory references to Section 4980H's exaction as a 'tax' thus render it a tax for purposes of the Anti-Injunction Act.").

93. See *CIC Servs., LLC v. IRS*, 141 S. Ct. 1582, 1589 (2021).

94. See *id.* at 1589–90 ("And in this context, that aim is not best assessed by probing an individual taxpayer's innermost reasons for suing. Down that path lies too much potential for circumventing the [AIA].").

95. Generally, the Declaratory Judgment Act (DJA), 28 U.S.C. § 2201(a), provides courts with the ability to "declare the rights and other legal relations of any

sought would have the effect of reducing tax, then the AIA bars the suit. As the Court explained in *Alexander v. “Americans United” Inc.*,⁹⁶ application of the AIA requires courts to look through the form of the pleadings toward the “objective” or the “obvious purpose” of the suit.⁹⁷ If the taxpayer’s stated purpose—which in *Americans United* was to reinstate tax-exempt status—“can be accomplished only by restraining the assessment and collection of a tax,” then the suit is barred by the AIA.⁹⁸ It makes no difference that the challenge is to a regulatory tax (as opposed to a revenue-raising tax) or that the challenge is stylized as an attack on some regulatory aspect of the statute.⁹⁹

The Court recently revisited the purpose test in *CIC Services, LLC v. IRS*,¹⁰⁰ largely reaffirming the rules from *Americans United* and *Bob Jones University v. Simon*¹⁰¹ but carving out an exception to the test.¹⁰² The Court held that a suit to enjoin an information-reporting requirement (required to be filed by a tax advisor, not a taxpayer) was *not* barred by the AIA, even though a violation of the reporting requirement could result in penalties (read: taxes) to the advisor.¹⁰³ The Court rejected the government’s position that the reporting requirement and the penalty were “two sides of the same coin”;¹⁰⁴ this was evident, the Court said, because the reporting obligations imposed obligations and costs other than paying tax, the connection between the filing obligation and the penalty was “too attenuated” for any injunction to be squarely aimed at the penalty, and finally because the penalties could result in criminal

interested party seeking such declaration.” The DJA, however, contains its own statutory exception for all “Federal taxes,” except certain declaratory actions relating to the status of certain charitable organizations. *Id.* Thus, the DJA provides its own, independent exception for maintaining a suit to restrain the assessment or collection of a tax. Nevertheless, courts have generally understood the AIA and DJA to be coextensive in their jurisdictional bar on pre-enforcement challenges to tax collection. *See Cohen v. United States*, 650 F.3d 717, 727–31 (D.C. Cir. 2011) (en banc); *Simon Coal Co. v. Apfel*, 226 F.3d 291, 299 (4th Cir. 2000); *In re Leckie Smokeless Coal Co.*, 99 F.3d 573, 583–84 (4th Cir. 1996).

96. 416 U.S. 752 (1974).

97. *Id.* at 760–61.

98. *Id.* In the companion case to *Americans United*, *Bob Jones University v. Simon*, the Court interestingly noted that a suit to preserve tax-exempt status would necessarily have the effect of restraining a tax because the taxpayer had pleaded that it would suffer irreparable injury if it lost given that “it would be subject to ‘substantial’ federal income tax liability.” 416 U.S. 725, 738–39 (1974).

99. *Fla. Bankers Ass’n v. U.S. Dep’t of Treasury*, 799 F.3d 1065, 1070–71 (D.C. Cir. 2015).

100. 141 S. Ct. 1582 (2021).

101. 416 U.S. 725 (1974).

102. *CIC Services, LLC*, 141 S. Ct. at 1589–90.

103. *Id.* at 1594.

104. *Id.* at 1590.

liability.¹⁰⁵ Although the full effects of *CIC Services* remain to be seen, there is some evidence that lower courts read the case as introducing a substantial exception to the test introduced under *Americans United* and *Bob Jones*. For example, the First Circuit ruled in *Harper v. Rettig*¹⁰⁶ that a taxpayer could pursue an injunction against IRS information gathering because the AIA “is ‘not keyed to all activities that may improve . . . [the] ability to assess and collect taxes,’” but only those “that occur[] before assessment [and] collection.”¹⁰⁷ In addition, the District Court for the Northern District of Texas recently held that *CIC Services* applied in an APA challenge seeking a declaration (as opposed to an injunction) and that the Declaratory Judgment Act’s bar on tax claims was coextensive with the AIA.¹⁰⁸

The importance of remedies for application of the AIA is illustrated by a pair of cases decided on May 15, 1922, regarding the so-called “child labor tax.”¹⁰⁹ In 1919, Congress had enacted a tax on child labor that imposed a ten percent excise on the net profits of certain businesses such as mines, mills, factories, and canneries that permitted children under fourteen (or sixteen, for some industries) to work there.¹¹⁰ *Bailey*

105. *Id.* at 1591–92. In so holding, the Court in *CIC Services* was silent as to whether it abrogated or overruled the D.C. Circuit’s decision in *Florida Bankers*, which held that a similar report by a bank could give rise to penalties. *See Fla. Bankers Ass’n*, 799 F.3d at 1067–68. In addition, the Court’s emphasis in *CIC Services* on criminal penalties corroborates Eli Nachmany’s thesis about the convergence of civil and criminal law in administrative law. *See* Eli Nachmany, *The Civil-Criminal Convergence*, 49 WAKE FOREST L. REV. 693, 735–36 (2024).

106. 46 F.4th 1 (1st Cir. 2022).

107. *Id.* at 7 (first quoting *CIC Services*, 141 S. Ct. at 1589; and then quoting *Direct Mktg. Ass’n v. Brohl*, 575 U.S. 1, 8 (2015)). *But see Franklin v. United States*, 49 F.4th 429, 434–35 (5th Cir. 2022) (concluding that the AIA bars a pre-enforcement challenge to a “procedural deficiency . . . [that] can technically be construed as occurring in a separation examination phase”).

108. *See Ryan LLC v. IRS*, No. 25-cv-00078, slip op. at *9 (N.D. Tex. Nov. 5, 2025) (“[T]he Court is not persuaded by the Government’s argument that the DJA’s federal tax exception is broader in scope than the Anti-Injunction Act’s bar on suits that obstruct the collection of taxes.”). As described above, the DJA technically provides a separate jurisdictional bar on actions seeking declarations “with respect to Federal taxes.” 28 U.S.C. § 2201(a); *see supra* note 95. However, courts generally have interpreted the AIA and DJA in parallel. *See Cohen v. United States*, 650 F.3d 717, 727 (D.C. Cir. 2011) (en banc). *But see Rivero v. Fidelity Invs., Inc.*, 1 F.4th 340, 343–45 (5th Cir. 2021) (suggesting that the DJA’s bar is wider and even that it applies to any declaratory actions “with respect to” taxes, not just those regarding assessment and collection (quoting *Warren v. United States*, 874 F.2d 280, 282 (5th Cir. 1989))). For our purposes, it is sufficient that the APA provides for both injunctive and declaratory remedies in pre-enforcement challenges, and that the AIA and DJA prohibit such challenges generally, if not in exactly the same set of circumstances.

109. *See Bailey v. George*, 259 U.S. 16, 16 (1922); *Bailey v. Drexel Furniture Co.*, 259 U.S. 20, 22 (1922).

110. Revenue Act of 1918, Pub. L. No. 254, § 1200, 40 Stat. 1057, 1138 (Feb. 24, 1919).

*v. Drexel Furniture Co.*¹¹¹ concerned a furniture manufacturer that was found liable for the tax, paid the asserted deficiency under protest, and then sued for a refund.¹¹² The Court did not consider the application of the AIA (because the tax had been paid, so the suit was essentially one for damages) and ruled the child labor tax unconstitutional on the merits.¹¹³ But in *Bailey v. George*,¹¹⁴ the taxpayer—a manufacturer of cotton products that had employed children in its business—sued the collector immediately prior to collection and won a permanent injunction on the ground that the tax was unconstitutional.¹¹⁵ The Court reversed with instructions to dismiss the case, noting only that the AIA bars a suit to enjoin the “collection” of taxes and that the claim of unconstitutionality could not remedy the jurisdictional defect.¹¹⁶ *George* thus established that the AIA can bar a claim for an equitable remedy even at a very late stage in the process of taxation: after the conduct underlying the tax has happened, an examination has been conducted, the tax has been assessed, and upon the eve of collection. That was so even when the underlying tax was unconstitutional. *A fortiori*, the AIA would bar a claim prior to the underlying conduct giving rise to the tax—which in the case of *Drexel Furniture* and *George* would be the taking on of children as employees.

The upshot of the AIA is that taxpayers lack the ability to challenge the applicability of a tax in district court until after the tax is paid—that is, by way of a refund suit.¹¹⁷ When a taxpayer pays the disputed tax and files suit in federal district court (or in the Court of Federal Claims), the remedy the taxpayer seeks—a refund—is essentially equivalent to damages and presents no demand for an injunction or declaration against

111. 259 U.S. 20 (1922).

112. *Id.* at 34.

113. *Id.* at 43–44.

114. 259 U.S. 16 (1922).

115. *Id.* at 19.

116. *Id.* at 20.

117. See *Enochs v. Williams Packing & Navigation Co.*, 370 U.S. 1, 7 (1962) (stating that the AIA “permit[s] the United States to assess and collect taxes alleged to be due without judicial intervention, and to require that the legal right to the disputed sums be determined in a suit for refund”); I.R.C. § 7422; 28 U.S.C. § 1346(a)(1). Note that the jurisdiction-granting statute for refund claims specifically requires both assessment and collection (in the case of bona fide taxes) or collection (in the case of penalties and other sums). I.R.C. § 7422(a); 28 U.S.C. § 1346(a)(1). It should be noted that the Code provides for several other causes of action by taxpayers against the IRS, such as an action in quiet title, foreclosure, partition, condemnation, interpleader, surplus proceeds, substituted sale proceeds, and substitution of value. See I.R.C. § 7426(a); 28 U.S.C. § 2410(a). None of these aim to restrain tax, but rather to allocate property interests between the IRS and the taxpayer or a third party. As a result, none of these actions present a suitable vehicle for taxpayers to challenge disputed tax liabilities, either pre- or post-enforcement.

assessment or collection of the tax.¹¹⁸ Federal courts applying the AIA are not shy about stating the underlying policy choice for the AIA, which is to “protect[] . . . the Government’s need to assess and collect taxes as expeditiously as possible with a minimum of pre-enforcement judicial interference.”¹¹⁹ Indeed, no court could restrain the assessment or collection of the tax in a refund suit because, by hypothesis, the tax has already been collected. The important point for our purposes is that, because the taxpayer can attack the disputed tax liability only by way of a refund suit, the transaction or activity that gives rise to the tax liability must have already transpired; otherwise, the tax liability could not be calculated and paid, and the taxpayer could not sue for a refund. The AIA thus generally forecloses pre-enforcement challenges in federal courts.¹²⁰

Exceptions to the AIA are quite limited, with there being one important statutory exception¹²¹ and two minor court-created exceptions. The major statutory exception is the Tax Court,¹²² in which Congress has

118. The *Flora* rule requires that the taxpayer pay the entire amount in dispute. Thus, if the taxpayer takes the position that a transaction should generate \$0 in tax, but the alternative position (that is, taken by the IRS) is that the transaction should generate \$100 in tax, the taxpayer must pay the \$100 to secure jurisdiction in court. A payment of \$99, for example, would not be sufficient, because in effect the suit seeks to restrain the assessment or collection of \$1 of tax claimed owed by the government. See *Flora v. United States*, 357 U.S. 63, 68–69 (1958).

119. *Bob Jones Univ. v. Simon*, 416 U.S. 725, 736 (1974).

120. The AIA generally restricts the jurisdiction of “any court” from any action to restrain assessment or collection of tax, I.R.C. § 7421(a), and that restriction applies both to federal district courts as well as suits in the Court of Federal Claims. See, e.g., *Jennette v. United States*, No. 2023-1152, 2023 WL 5839294, at *2 (Fed. Cir. Sep. 11, 2023) (noting that the Court of Federal Claims lacked jurisdiction over a tax claim because it has jurisdiction only over refund claims and the taxpayer had not paid the amount in dispute).

121. There are several minor (and very precise) statutory exceptions to the AIA, such as for innocent spouse relief, I.R.C. § 6015, penalties payable by tax return preparers, *id.* § 6694, suits by third parties to recover an interest in property sold to satisfy a tax liability, *id.* § 7426(a)–(b)(1). *Id.* § 7421(a) (“Except as provided in sections 6015(e), 6212(a) and (c), 6213(a), 6232(c), 6330(e)(1), 6331(i), 6672(c), 6694(c), 7426(a) and (b)(1), 7429(b), and 7436, no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person . . .”). In quality, none of these exceptions really provide an adequate means to challenge disputed tax liability.

122. The AIA specifically excepts from its bar the provisions of § 6213(a), which permits a taxpayer residing in the U.S. to petition for review in the Tax Court within ninety days of receiving a notice of deficiency. Section 6213(a) specifically provides that the IRS “may be enjoined” (by the Tax Court or another court) if it seeks to assess or collect the asserted deficiency either during the ninety-day petition window or after a petition is successfully filed. See *id.* § 6213(a).

graciously provided taxpayers a forum for prepayment challenges.¹²³ Unlike suits in district courts and the Court of Federal Claims, taxpayers need not pay the disputed tax to file an action in the Tax Court. But the Tax Court's status as a forum where prepayment suits may be heard should not be confused with a forum where a taxpayer could bring a pre-enforcement suit (in the manner of *Abbott Labs* or *Ex parte Young*). The Tax Court's doors remained closed to those who would bring such challenges. That is because a valid Tax Court petition requires the sending of a notice of deficiency to the taxpayer.¹²⁴ In turn, a notice of deficiency requires (unsurprisingly) a deficiency,¹²⁵ which is generally defined in reference to the amount of tax shown on the taxpayer's return.¹²⁶ Generally, this means that challenges before the Tax Court are also retrospective. They concern transactions and activities that not only have already occurred, but with respect to taxable years that have already closed. Tax cases heard by the Tax Court and those heard in district courts (or the Court of Federal Claims) are thus similar in the respect that neither permits taxpayers to seek review of the tax law's application to specific transactions or activities prior to undertaking those transactions or activities.

The judicial exceptions are also largely unhelpful to taxpayers who would file pre-enforcement challenges. In *Enochs v. Williams Packing & Navigation Co.*,¹²⁷ the Court ruled that the AIA does not apply when the taxpayer establishes that "under no circumstances could the Government ultimately prevail" on the merits.¹²⁸ This is to say that the *Williams Packing* exception will be available not when the tax law is uncertain (that is, when pre-enforcement challenges are most appropriate), but when the tax law is indisputable that the IRS is in the wrong. The Court also found an exception to the AIA in *South Carolina v. Regan*¹²⁹ for "actions brought by aggrieved parties for whom [Congress] has not provided an alternative remedy."¹³⁰ But of course in

123. The Supreme Court has repeatedly explained that there is no constitutional right to a forum prior to payment of tax. See *Reich v. Collins*, 513 U.S. 106, 111 (1994); *Phillips v. Comm'r*, 283 U.S. 589, 595–97 (1931).

124. See I.R.C. § 6213(a).

125. See *id.* § 6212(a).

126. *Id.* § 6211(a)(1)(A).

127. 370 U.S. 1 (1962).

128. *Id.* at 7.

129. 465 U.S. 367 (1984).

130. *Id.* at 378. The plaintiffs that typically succeed under the *Regan* exception are likely to be states, precisely because they are not taxpayers themselves, and the injury they suffer as a result of a federal tax law will be some diminution in their own tax revenues. See, e.g., *New Jersey v. Bessent*, 149 F.4th 127, 143 (2d Cir. 2025) ("Appellants' suits are not aimed at vindicating the rights of taxpayers so much as remedying their *own* injuries resulting from the Final Rule—the revenues lost from diminished contributions.").

the ordinary case where a tax liability is uncertain, the taxpayer will have recourse to the standard administrative refund procedures in addition to a prepayment petition in the Tax Court or a refund claim, making the *Regan* exception inapplicable.¹³¹ In sum, the statutory and judicial exceptions to the AIA provide no haven to taxpayers seeking to eliminate ex ante tax risk.

3. Ex Ante Tax Risk

Through the AIA, Congress has shut the courthouse doors to pre-enforcement challenges by taxpayers. Put differently, because *Abbott Labs* or *Ex parte Young*-type suits will almost certainly aim at restraining the assessment or collection of the disputed tax liability, such suits are barred by the AIA. As a result, taxpayers cannot determine the tax effect of a transaction prior to engaging in the transaction. That result strands taxpayers in a state of ex ante tax risk: Although the risk itself rises from the causes identified in the classical story of tax law uncertainty, the AIA removes the process that could provide certainty. Vis-à-vis other regulated parties, taxpayers are at a significant disadvantage in determining the regulatory treatment of their behavior prior to engaging in that behavior. This is, of course, a policy choice.

Whether that policy choice is justified is beyond the scope of this Article. Indeed, many thoughtful reasons for the AIA exist. As the Court has explained, and many courts have repeated afterward, the “principal purpose” of the AIA is “to be the protection of the Government’s need to assess and collect taxes as expeditiously as possible with a minimum of pre-enforcement judicial interference.”¹³² This is to say that the AIA does not aim at ex ante tax risk as such; rather, ex ante tax risk is a necessary consequence of the policy choice embedded in the AIA.¹³³

One response to all of this is that pre-enforcement challenges would be impractical even without the AIA. After all, business moves fast, meaning taxpayers might not be willing to endure protracted litigation against the IRS in order to eliminate ex ante tax risk. In addition, one

131. See *Maze v. IRS*, 862 F.3d 1087, 1093 (D.C. Cir. 2017) (describing how *Regan* did not apply when ability to file administrative claim and refund suit were available to taxpayer).

132. *Bob Jones Univ. v. Simon*, 416 U.S. 725, 736 (1974).

133. In this respect, the AIA operates differently than “strategic tax law uncertainty” as described and criticized by Leigh Osofsky. See Leigh Osofsky, *The Case Against Strategic Tax Law Uncertainty*, 64 TAX L. REV. 489, 489–90 (2011) (defining strategic tax law uncertainty as the government “strategically withholding tax law guidance, so that taxpayers have less certainty regarding their tax liability”). Although a court judgment resulting from a pre-enforcement challenge might have similar features to “tax law guidance,” Osofsky’s concern is primarily about tax administrators refraining from providing clarity on substantive law, rather than what Congress has done with the AIA: enact a flat procedural prohibition. See *id.*

fixed star of our income tax system is that it is computed on an annual basis,¹³⁴ but this means that litigation—which often lasts several years—might not be resolved in time to file returns on a current basis. Litigation is also expensive, meaning only the wealthy (or high-performing businesses) might be willing to file pre-enforcement challenges, and even then, only for issues that implicate high-value tax liabilities.¹³⁵ All in all, these considerations might mean that few pre-enforcement challenges would be brought in a no-AIA world.¹³⁶

Be that as it may, some *would* be brought, and the effects would go a long way in mitigating ex ante tax uncertainty. There are at least four reasons to think this. First, and most simply, a taxpayer who brings a pre-enforcement challenge will—one way or another—eliminate their ex ante tax risk. If they prevail on the merits, lose on the merits, or reach a settlement with the IRS, the taxpayer will have determined with certainty the tax consequences of the contemplated transaction. Second, whatever the number of pre-enforcement challenges brought, any challenge reaching the merits will provide important data points to other taxpayers. A taxpayer victory on certain facts could provide planning opportunities for other taxpayers, who might structure transactions similarly in order to more confidently achieve beneficial tax treatment. Third, pre-enforcement challenges present different strategic considerations for taxpayers than do Tax Court petitions or refund litigation. Namely, a hypothetical pre-enforcement challenger's expected costs include litigation expenses and, if the challenge fails, a foregone transaction. The challenger will never pay the underlying tax liability. As a result, pre-enforcement challengers endure fewer costs in reaching the merits. Post-transaction litigation, by contrast, tilts heavily toward settlement because failed cases will ultimately require the deficiency to be paid, plus penalties and interest. Consequently, it is possible that pre-enforcement challenges might yield more rulings on the merits. Fourth, the threat of litigating in a defensive posture might prompt the IRS to proactively resolve certain tax questions. In cases where this makes sense,

134. See I.R.C. § 441(a) (“Taxable income shall be computed on the basis of the taxpayer’s taxable year.”).

135. This would suggest a kind of violation of horizontal equity, namely that pre-enforcement challenges are, as a practical matter, available only to the well-heeled and that challenges actually brought will focus on tax issues particularly important to the wealthy, rather than focus on issues common to all taxpayers or to the less well-off.

136. One could add to this list that taxpayers seeking injunctions are unlikely to file because the availability of a refund claim means they are unlikely to establish irreparable harm. See *Lovell v. United States*, 795 F.2d 976, 977–78 (11th Cir. 1986). Be that as it may, taxpayers would still generally be permitted to seek a declaration as to the unlawfulness of the asserted tax without showing irreparable harm. While a subsequent action would be required to enforce the declaration, ultimately the declaration itself would resolve any tax uncertainty from the perspective of the taxpayer.

administrative action would provide additional data points to taxpayers seeking to resolve tax questions.

The AIA is ultimately a policy choice, one that Congress made after the Civil War and has hardly deviated from since. That policy choice has the effect of leaving any taxpayer facing ex ante tax risk without a forum to conclusively resolve that risk. The AIA thus presents a missing piece in the classical story of tax law. Although rules and standards generate the legal uncertainties, the AIA denies taxpayers a mechanism available to virtually all other regulated parties to resolve such uncertainties.

II. THE “OLD MARKET” FOR ADDRESSING TAX RISK

Taxpayers have not accepted ex ante tax risk lying down. For decades, taxpayers have made arrangements with counterparties and advisors, in addition to seeking advance rulings from the IRS. The purpose of each of these arrangements is to reduce as much as reasonably possible any ex ante tax risk embedded in a transaction. This Part describes the so-called old market¹³⁷ for ex ante tax risk products. However, unlike most of the literature that discusses the old market, this Part concludes that none of the arrangements are sufficient to achieve certainty ex ante from the taxpayer’s point of view. The four products and arrangements discussed in this Part are (1) warranties provided by tax professionals, (2) formal opinions provided by tax advisors, (3) tax indemnity arrangements, and (4) private letter rulings from the Service.

A. Advisors and Preparer Warranties

Few American taxpayers prepare their own tax returns, instead relying on paid preparers or software.¹³⁸ For a long time, this relationship has given rise to preparer warranties, essentially a guarantee by the preparer (or now, the purveyor of the software) that the return is correct and free of errors.¹³⁹ Such warranties are nearly as old as the income tax itself, and evidence exists that preparers sometimes indemnified taxpayers for additional taxes owed solely on account of a mistake made by the preparer.¹⁴⁰ Now, however, the standard modern preparer

137. This Part adopts the term “old market” following Logue’s article on tax insurance, which was the first to address tax insurance. See Logue, *supra* note 3, at 376.

138. According to the Government Accountability Office, in 2018, about 90 percent of individual taxpayers relied on either a paid preparer or tax preparation software to file their return. U.S. GOV’T ACCOUNTABILITY OFF., GAO-19-340, TAXPAYER INFORMATION: IRS NEEDS TO IMPROVE OVERSIGHT OF THIRD-PARTY CYBERSECURITY PRACTICES 1 (2019).

139. See Logue, *supra* note 3, at 376–77.

140. For example, in *Clark v. Commissioner*, a tax preparer advised a couple to make an election to file a joint return, thus causing them to pay about \$20,000 more

warranty will cover interest and penalties that arise as a result of a mistake by the preparer.¹⁴¹ Sarah Lawsky has documented that most mass-market tax preparers provide warranties, but these warranties typically cover only the costs (economic and emotional) of being subjected to audit by the IRS.¹⁴²

Advisor warranties generally are not sufficient to blunt the effects of ex ante tax risk because taxpayers cannot recover the underlying tax deficiency. The mass-market warranties identified by Lawsky cover, in the main, the costs incurred as a result of an audit.¹⁴³ And broader warranties will generally only extend to penalties and interest arising from an underpaid tax liability, which was caused by an error of the preparer.¹⁴⁴ In other words, because the preparer warranty covers only the incremental economic costs that attach to a tax deficiency, but not the deficiency itself, the taxpayer remains no better off than had she taken the conservative tax position and paid the tax up front.

Another type of professional warranty is that provided by tax advisors. Advisor warranties operate as contingent fee arrangements: If a tax advisor recommends a tax position to the taxpayer in exchange for a fee, and that position is not sustained by the IRS, the advisor will refund the fee.¹⁴⁵ These arrangements differ from preparer warranties in that the trigger for repayment is not a mistake in preparing a return, but that the position did not comply with the law.¹⁴⁶ In addition, while preparer warranties might cover the entirety of a taxpayer's return (and thus all transactions reported on that return), advisor warranties typically cover only the transaction with respect to which advice was given.¹⁴⁷ And, of course, the taxpayer's protection is limited by the fee that she pays to the advisor. As a result, advisor warranties are a poor offset to ex ante tax

in tax in the aggregate than if they had filed separate returns. 40 B.T.A. 333, 334 (1939). The preparer indemnified the couple for that amount, and the IRS sought to tax the indemnity payment. *Id.* The Board of Tax Appeals rejected the IRS's assertion of additional tax, explaining that the preparer's payment was simply "compensation for a loss which impaired petitioner's capital." *Id.* at 335.

141. See Logue, *supra* note 3, at 377 ("[T]he standard tax preparer warranty typically limits coverage to preparer errors of some kind and thus leaves taxpayers themselves responsible for any interest or penalties caused by their own mistakes or malfeasance.").

142. Sarah B. Lawsky, *Fairly Random: On Compensating Audited Taxpayers*, 41 CONN. L. REV. 161, 174–77 (2008).

143. *Id.* at 175 (describing audit protection provided by H&R Block and TurboTax).

144. See Logue, *supra* note 3, at 376–77.

145. *Id.* at 382–83. Importantly, this construct differs from the facts in *Clark*, in which the preparer-advisor refunded the actual difference in tax liability, not the fee arising from their services. See *Clark*, 40 B.T.A. at 334.

146. See Logue, *supra* note 3, at 382–83.

147. See *id.* at 382 & n.82.

risk because the taxpayer's protection is generally quite small. In any event, advisor warranties have been a preferred tool of tax-shelter promoters, and the Service has effectively banned such arrangements via Circular 230 and by labelling such arrangements as "reportable transactions" that must be disclosed to the Service.¹⁴⁸

B. Opinions

Tax advisors also routinely provide written opinions to clients about the tax treatment of sophisticated transactions. Because these opinions are tailored to the facts underpinning the particular transaction and represent the considered view of the advisor (and their firm) of the tax treatment of the transaction,¹⁴⁹ these opinions are not altogether different in style from judicial opinions. For example, prior to engaging in a spin-off transaction wherein a corporation distributes stock of its corporate subsidiary to shareholders, the corporation's tax advisors may draft a formal opinion concluding that the transaction would qualify as a tax-free distribution under § 355 of the Code.¹⁵⁰ The advisor will typically express their confidence in the opinion by using certain terms of art, such as that the transaction "will" or "should" be treated as tax free, is "more likely than not" to be treated as tax free, or that treating the transaction as tax-free is based on "substantial authority" or otherwise has a "reasonable basis."¹⁵¹

Unlike tax advisor warranties, advisor-provided tax opinions do not provide a money-back guarantee. Rather, opinions provide protection against the imposition of accuracy-related penalties if the IRS or a court disagrees with the position taken by the taxpayer (as supported by the opinion).¹⁵² When a taxpayer substantially understates their income (or meets other conditions), § 6662 imposes a penalty equal to 20 percent of the underpayment.¹⁵³ However, a taxpayer will not be liable for penalties under § 6662 (including the substantial understatement penalty) if the

148. See 31 C.F.R. §§ 10.0–10.93 (2008); Treas. Reg. § 1.6011-4(b)(4) (defining "[a] transaction with contractual protection" as "a transaction for which the taxpayer . . . has the right to a full or partial refund of fees . . . if all or part of the intended tax consequences from the transaction are not sustained"). Note also that Circular 230 exempts advisors retained to pursue refund claims from the general prohibition on contingent fees, presumably because the entire amount of tax has already been paid, as previously explained in Section I.B.

149. See Foster, *supra* note 14, at 484; see also Robert P. Rothman, *Tax Opinion Practice*, 64 TAX LAW. 301, 301 (2011) (describing trends in tax advisor opinion practice).

150. See I.R.C. § 355.

151. See Linda Galler, *Tax Opinion Policies and Procedures*, 65 TAX LAW. 443, 454–61 (2022) (describing different levels of assurance given in tax opinions).

152. See Rothman, *supra* note 149, at 388.

153. I.R.C. § 6662(a), (b)(2).

taxpayer shows that the taxpayer had “reasonable cause” for the underpayment and that “the taxpayer acted in good faith,” which may be present when a taxpayer reasonably relies on its tax professional.¹⁵⁴ The applicable Treasury Regulations confirm that reliance upon “the opinion of a professional tax advisor” can establish the reasonable cause exception, but only if the advice is based on “all pertinent facts and circumstances,” the advice is not “based on unreasonable factual or legal assumptions” (including any representations made by the taxpayer), and the taxpayer did not rely on an opinion that a Treasury Regulation is invalid.¹⁵⁵ In other words, securing and relying upon the opinion of counsel about an uncertain tax situation is not an ironclad defense against penalties, but it is quite close.

As helpful as advisor opinions might be, reliance upon them does not put the taxpayer in an economically better position on the whole. At best, as with preparer warranties, reliance on advisor opinions simply insulates the taxpayer from certain costs that may arise as a result of a challenge by the IRS, namely certain penalties. But reliance on these opinions does not relieve the taxpayer of the obligation to pay the underlying disputed tax liability. Taxpayers relying on the opinion of counsel must simply absorb that risk *ex ante*.

Professor Heather Field has argued that the protection provided by formal tax opinions is, in fact, much greater. According to Field, advisor opinions not only function as insulation against penalties, but they also “shift some portion of [tax] risk from the taxpayer to the opinion writer,” meaning “that indemnification . . . is *part* of the economic relationship between a client and a lawyer who provides a tax opinion.”¹⁵⁶ Field argues that this indemnification arrangement arises in the form of a malpractice claim against tax advisors; that is, if a taxpayer relies on the written opinion of counsel in taking a position and the position is successfully challenged by the IRS, then a malpractice claim under state law might lie against the advisor.¹⁵⁷ In an important sense, Field’s observation is indisputable: A taxpayer’s retention of a tax advisor *does* open up the possibility of a malpractice claim against the advisor, and if the taxpayer succeeds in a malpractice action, then the taxpayer could

154. See *id.* § 6664(c)(1). The leading Tax Court case on the reasonable cause exception states that, to be insulated from penalties, a taxpayer must prove that “(1) [t]he adviser was a competent professional who had sufficient expertise to justify reliance, (2) the taxpayer provided necessary and accurate information to the adviser, and (3) the taxpayer actually relied in good faith on the adviser’s judgment.” *Neonatology Assocs., P.A. v. Comm’r*, 115 T.C. 43, 99 (2000).

155. Treas. Reg. § 1.6664-4(c)(1).

156. Heather M. Field, *Tax Lawyers as Tax Insurance*, 60 WM. & MARY L. REV. 2111, 2118–19 (2019).

157. *Id.* at 2133, 2139–40.

recoup any additional taxes paid. Several cases evidence this fact.¹⁵⁸ But (as even Field acknowledges) such recovery is likely a long shot.¹⁵⁹ A malpractice claim will lie against the advisor only if the advisor breaches the standard of care (as determined under state law),¹⁶⁰ which is often a high bar; tax opinions are often drafted with elaborate caveats and qualifications, and they are by their own terms good only to the extent of the client's own representations; and clients may be reluctant to sue lest they sour a relationship with a trusted advisor or signal to future advisors that they are litigious. Thus, it is unlikely that even sophisticated taxpayers, who are most capable of pursuing malpractice claims, would treat malpractice claims as an important tool to control against ex ante tax risk or place a high dollar value on such claims. At the very least, that value (when appropriately discounted) is unlikely to meaningfully offset the expected value ex ante of many tax risks.

C. Indemnities

Generally, a tax indemnity—just like any other indemnity—requires one contracting party to reimburse the other for certain losses (specifically tax losses) that might arise out of the transaction.¹⁶¹ Tax indemnities can cover many different kinds of taxes and tax structures. For example, parties will often allocate the cost of transfer taxes imposed on a transaction among themselves. Withholding taxes imposed on outbound payments of interest on debt instruments are also the frequent subjects of tax indemnities; if the tax indemnity applies, then the borrower “grosses up” the payment to the lender so that the lender receives an amount it would have received in the absence of the withholding tax. In many routine cases, such as those described here, the application of the tax law to the subject of the indemnity can be known with some confidence. Accordingly, such indemnities are not about allocating *risks* between the parties. Instead, they are about known *costs* between them.¹⁶²

But tax indemnities are also used to allocate tax risks when the law is not clear or when the risks are simply unknown. Such risks arise in virtually every business acquisition because buyers will quite reasonably

158. *Id.* at 2161 (discussing malpractice claims in various cases).

159. *Id.* at 2159 (noting that a taxpayer's ability to recover “is limited”).

160. *Id.* at 2141, 2143.

161. *See* Logue, *supra* note 3, at 385–87.

162. *See* Robert W. Wood & Dominic L. Daher, *Beating a Dead Horse: Tax Indemnity Payments to Ex Spouses*, 101 TAX NOTES 875, 875 (2003) (“Tax indemnity payments are common features of many transactions, such as litigation settlement agreements, merger documents, purchase and sale agreements, leases, and so forth. Regardless of the context, in general, they say: ‘If you get taxed as a result of the transaction, I’ll cover it.’”).

demand that the seller represent that all taxes due and payable by the company have in fact been paid.¹⁶³ If that representation turns out not to be true and there was a tax that went unpaid, the seller will pay damages to the buyer, with the amount of the damages roughly equaling the underpaid tax (plus interest and penalties).¹⁶⁴ Setting aside taxes that the seller knew were owed and deliberately failed to pay—which could rise to fraud—such indemnities essentially cover (1) tax risks known to the seller, but which were not sufficiently risky to warrant paying the tax; and (2) unknown tax risks, in each case identified and sustained upon audit. In addition, tax indemnities can be established by the parties for known tax risks created by the transaction itself.¹⁶⁵ For example, if it is uncertain whether the transaction will qualify as a tax-free reorganization or the transaction will trigger tax to one party, but the tax is based on an uncertain valuation, then one party might indemnify the other.

While helpful in the right circumstance, tax indemnities are not a panacea to ex ante tax risk. In the first place, an indemnity arrangement presupposes that there is some related party to which tax risk could conceivably be shifted. But not all tax risks are susceptible to shifting in that manner. Consider the humble S corporation.¹⁶⁶ S corporations, as a general matter, do not pay income tax,¹⁶⁷ instead passing income along to shareholders much like a partnership.¹⁶⁸ This means that qualification as an S corporation is important, because failure to qualify will mean that tax liabilities that should have been paid at the corporate level were not. Moreover, qualification is often very risky because S corporation status turns on the number of shareholders, their citizenship, whether they are individuals or businesses, and the characteristics of the shares.¹⁶⁹ But if

163. See Lawrence Zelenak, *The Taxation of Tax Indemnity Payments: Recovery of Capital and the Contours of Gross Income*, 46 TAX L. REV. 381, 382 (1991) (“A tax indemnity payment is made when a seller represents to a purchaser that the asset being sold is eligible for favorable tax treatment, and it later develops that the representation was inaccurate.”).

164. Although governed by state law, such a misrepresentation typically must be either fraudulent or material to result in a violability remedy, meaning damages remain the buyer’s default remedy. See RESTATEMENT (SECOND) OF CONTS. § 164 (A.L.I. 1981).

165. In each case, the seller will have violated the representation that it paid all taxes that are due and payable because, by hypothesis, a taxing authority asserted and collected an unpaid tax. This is a misrepresentation. See *id.* § 159 (defining misrepresentation). But it does not rise to the level of a fraudulent misrepresentation because the taxpayer reasonably believed that the tax was not due and payable, either because the taxpayer thought the incremental tax was not legally supportable or was simply unaware of the risk of the incremental tax. See *id.* § 162(1) iii (defining fraudulent misrepresentation).

166. S corporation status, in part for the reasons discussed here, happens to be one of the tax risks most commonly insured by tax insurers. See *infra* note 214.

167. See I.R.C. § 1363(a).

168. See *id.* § 1366.

169. See *id.* § 1361(b).

an S corporation wanted to shift this tax risk away, to whom would it shift it? One might respond that the shareholders should indemnify the would-be S corporation. But that does not constitute a true risk shift: The shareholders, by dint of their position, already bear the economic burdens (and benefits) of the corporation. And apart from the shareholder, there is no other obvious party that could take on this risk. Thus, at least some tax risks—and some very common ones—are not easily susceptible to risk shifting via indemnity.

Moreover, even if there is a transacting party willing to accept tax risk, it is not certain that such party will be willing to absorb *all* the tax risk. Like any indemnity arrangement, tax indemnities are infinitely customizable. The parties can confine the indemnity only to certain taxes, require that the indemnified party cover certain losses prior to seeking to recover (*i.e.*, impose a deductible), set a cap on the indemnity, or provide other limitations on the ability to seek recovery. The indemnified party therefore may not be fully indemnified with respect to their tax exposure, meaning they retain a portion of the *ex ante* tax risk.

But perhaps the greatest insufficiency with respect to tax indemnities is that they do not relocate tax risk outside the transaction. Tax indemnities reapportion tax risk between parties to the transaction, but if the IRS successfully challenges some tax position with respect to which there is an indemnity, the cost will fall on one or both parties. In other words, tax indemnities do not create value to the parties, which value can offset the tax risk presented by the transaction. Instead, tax indemnities simply relocate the risk (or some portion of the risk) to the counterparty. And that, in turn, requires the counterparty to be willing to accept the risk.¹⁷⁰

Indeed, tax indemnities are generally on the decline for precisely this reason: Many counterparties are simply not willing to take on the risk required to provide substantial indemnities, including tax indemnities. The rise of private equity in the mergers and acquisitions space has changed the fundamental economics of some deals, such that the allocation of risk that would typically be handled via an indemnity (including a tax indemnity) is now shifted to a third-party insurer through a financial product called representation and warranty insurance (RWI).¹⁷¹ Because indemnities (including tax indemnities) are typically

170. See Logue, *supra* note 3, at 386 (noting that transaction parties may have different risk profiles, and those profiles may turn on factors like who has more assets or information).

171. See generally Sean J. Griffith, *Deal Insurance: Representation and Warranty Insurance in Mergers and Acquisitions*, 104 MINN. L. REV. 1839 (2020) (analyzing the use of RWI in dealmaking contexts). To a certain extent, RWI is similar to tax insurance in that it shifts the risk to a third party. However, RWI and tax insurance differ in that RWI is primarily targeted at unknown risks that might rise to a level of a breach of a representation.

satisfied by tying up funds in escrow accounts for long periods of time, indemnities reduce the seller's internal rate of return and are thus unattractive to private equity sellers.¹⁷² The fact that private equity market participants simply cannot stomach the economics of a tax indemnity illustrates the problem with these arrangements—they do not minimize or eliminate tax risks with respect to the parties to a transaction, and they simply allocate the risks among them. For that reason, obtaining a comprehensive tax indemnity can be difficult to achieve, leaving taxpayers exposed to ex ante tax risk.

D. Private Letter Rulings

Private Letter Rulings (PLRs) are the best hope for a taxpayer facing an economically significant ex ante tax risk. Taxpayers typically approach the Service about a PLR “in order to obtain some measure of certainty or security with respect to the position of the Service” about certain stated facts.¹⁷³ Since 1954, a taxpayer that secures a PLR from the Service is “protected if the ruling was in error or the Service subsequently changed its position.”¹⁷⁴ In other words, a taxpayer receiving a favorable¹⁷⁵ PLR extinguishes virtually all ex ante tax risk with respect to the covered transaction. Nevertheless, the Service might still seek to collect from the taxpayer if the facts differ from those represented to the Service in the PLR request.¹⁷⁶

As promising as PLRs may be in theory, they are rarely a practical solution for many taxpayers. Soliciting the learned consideration of the Service takes time. As Professor William Foster has detailed, the timeline in which taxpayers can anticipate a response from the IRS (to say nothing of whether the response will be positive) ranges from three weeks to have an official contact a taxpayer, to up to nine months to receive the finalized

172. See *id.* at 1905.

173. Dale F. Rubin, *Private Letter and Revenue Rulings: Remedy or Ruse*, 28 N. KY. L. REV. 50, 51 (2001); Mitchell Rogovin & Donald L. Korb, *The Four R's Revisited: Regulations, Rulings, Reliance, and Retroactivity in the 21st Century: A View from Within*, 46 DUQ. L. REV. 323, 342–43 (2008) (“A letter ruling is a written statement issued to a taxpayer . . . that interprets and applies the tax laws to a specific set of facts. Rulings are . . . generally issued in respect to transactions that have not been consummated.” (footnote omitted)).

174. Rubin, *supra* note 173, at 52.

175. But see Noah Hertz Marks, *Winning by Losing: The Strategy of Adverse Private Letter Rulings*, 66 B.C. L. REV. 659, 663 (2025) (establishing that taxpayers sometimes intentionally secure an unfavorable PLR).

176. To that extent, a PLR represents a kind of quasi-contract between the taxpayer and the government. Assuming the facts are as the taxpayer represents, then the taxpayer may claim favorable tax treatment pursuant to the contract. However, if the facts deviate, then the contract is void for misrepresentation.

ruling.¹⁷⁷ Of course, that does not take into account the time required by the taxpayer's advisors to determine that seeking a PLR is viable or to assemble the relevant materials to submit to the IRS. It is possible that seeking a PLR is entirely unworkable because the tax year in which a position must be taken could lapse before a favorable PLR issues. Helpfully, the Service has introduced (and made permanent) a "fast track" program for certain corporate taxpayers to receive PLRs in approximately twelve weeks.¹⁷⁸ While the program is a step in the direction of taxpayer certainty, the program remains available only to a narrow class of taxpayers.

Another issue with PLRs for taxpayers seeking certainty is that the number of issues on which the IRS will rule is severely limited. As Professor Emily Cauble has recently explained:

The IRS will not issue letter rulings on certain topics. At the beginning of each year, the IRS issues a revenue procedure containing the most up-to-date list of topics on which it will not rule, and if the IRS decides to modify the list before the beginning of the next year, it will issue a revenue procedure providing any updates.¹⁷⁹

This list includes general topics on which the IRS will not rule, specific topics on which it will not rule, topics on which it "ordinarily" will not rule, and topics on which it will not rule at all.¹⁸⁰ Regrettably, many of these topics are those governed by standards—broad facts-and-circumstances tests—where ex ante tax risk is most acute and taxpayers are most in need of certainty. By Cauble's count with respect to the 2021 taxable year, the IRS would not rule on 141 particular topics and ordinarily would not rule on 63 topics.¹⁸¹ By 2023, the list had expanded slightly (to 152 and 64, respectively).¹⁸² To the Service's credit, in 2024, the applicable Revenue Procedure was updated to provide that the IRS would rule on certain extraordinary corporate transactions, such as complete liquidations, tax-free contributions to a corporation, and certain corporate reorganizations.¹⁸³ While this is a small win for taxpayer

177. Foster, *supra* note 14, at 490.

178. See Rev. Proc. 2022-10, 2022-6 I.R.B. 473 (introducing the pilot program); Rev. Proc. 2023-26, 2023-33 I.R.B. 486 (making the program permanent).

179. Emily Cauble, *Questions the IRS Will Not Answer*, 97 IND. L.J. 523, 525-26 (2022) (footnote omitted).

180. *Id.* at 526.

181. *Id.*

182. See Foster, *supra* note 14, at 492.

183. Rev. Proc. 2024-1, 2024-1 I.R.B. 1; Rev. Proc. 2024-3, 2024-1 I.R.B. 143; see also Chandra Wallace, *IRS to Expand Scope of Corporate Letter Rulings*, 181

certainty, issues on which taxpayers are able to obtain the IRS's consideration (to say nothing of its approval) remain quite limited.¹⁸⁴

In addition to the previously described, which go to the contingencies of what makes PLRs unattractive or unavailable to taxpayers, there is a larger, structural issue with PLRs. Namely, a taxpayer contemplating pursuing a PLR is already in a state of risk with respect to its tax positions, yet pursuing the PLR may actually *worsen* its risk position. As Professor Yehonatan Givati has persuasively argued, a taxpayer deliberating about whether to seek a PLR faces five “strategic reasons” not to apply for a PLR, and only two reasons in favor.¹⁸⁵ The reasons counseling against are as follows: (1) whereas audit rates are quite low on average, applying for a PLR guarantees that the Service will review the risky position; (2) even in industries where audit rates are very high, audits do not always detect risky positions, but requesting a PLR does just that; (3) Service officials who consider PLR requests are typically from the national office, meaning they are less likely to make mistakes in applying the law than district examiners that review on audit; (4) because a favorable decision in a PLR has de facto precedential value (whereas a favorable decision in audit remains private), the Service may be disinclined to rule favorably; and (5) whereas an unfavorable ruling effectively forecloses the transaction, deciding against applying for a ruling puts pressure on the Service to rule favorably on audit because of the threat of litigation.¹⁸⁶ The taxpayer also has two strategic benefits: (1) requesting a PLR avoids penalties, and (2) applying for a ruling puts pressure on the Service to rule favorably, lest the taxpayer engage in an alternate transaction (or no transaction) that would result in less revenue collected.¹⁸⁷ Recent scholarship has suggested that, at least for large public firms, there may be a third benefit to applying for PLRs: lower audit rates from the IRS, at least if the application for the PLR is successful.¹⁸⁸

In many cases, these concerns may be difficult to balance—they might even be incommensurable. Even if a taxpayer has the time to seek

TAX NOTES FED. 752 (2023) (describing new issues on which the IRS determined it would issue PLRs).

184. The IRS also seems incapable of issuing a high volume of PLRs, having not issued more than 1,000 rulings per year since 2017. *See Marks, supra* note 175, at 683.

185. Yehonatan Givati, *Resolving Legal Uncertainty: The Unfulfilled Promise of Advance Tax Rulings*, 29 VA. TAX. REV. 137, 140–41 (2009).

186. *Id.* at 156–64.

187. *Id.* at 164–68.

188. *See* Andrew Belnap, Read Hadfield & Jeffrey L. Hoopes, Does Voluntary Private Tax Disclosure Reduce IRS Audit Risk? 4 (Sep. 2025) (unpublished manuscript) (on file with author) (finding that audit rates reduce by approximately 23.1% for firms that disclose a PLR). In addition, after seeking to control for changed firm behavior, this study found that firm behavior is not the likely cause of the reduction in audit rates. *Id.*

a PLR and the IRS is willing to rule on the issue presented, the concerns Givati identifies suggest that the availability of PLRs will not simply flip a switch for the taxpayer from significant risk to zero risk.¹⁸⁹ Instead, applying for the PLR introduces risks of its own, and those risks distort (or even worsen) the taxpayer's ex ante risk assessment with respect to the tax position. As a result, even if the Service had the willpower and capacity to make PLRs available to significant numbers of taxpayers, there is good reason to think that this may not sufficiently diminish the kind of ex ante tax risk knowingly countenanced by our tax laws.

III. TAX INSURANCE

This Part turns back to tax insurance. First, it provides a brief primer on tax insurance—its history and the basic economic terms underlying each tax insurance policy. In particular, these economic terms can be sufficient to eliminate ex ante tax risk to the taxpayer, unlike the old market arrangements.¹⁹⁰

Next, this Part analyzes the core economic terms of a tax insurance policy and concludes that they mirror (from the taxpayer's point of view) the economic benefit and burden that the taxpayer would get from a pre-enforcement challenge, if such challenges were available. Thus, tax insurance is essentially equivalent to a pre-enforcement challenge, at least from the taxpayer's point of view. The primary economic differences between tax insurance and pre-enforcement challenges are the party to which the risk is shifted (that is, the insurer rather than the government) and, possibly, pricing, but neither of these changes the fundamental economic deal from the taxpayer's perspective.

Finally, this Part describes the dramatic surge in the use of tax insurance in recent years and proposes several reasons why that surge might be occurring. It then takes these trends and extrapolates from them the possibility that tax insurance might evolve further. In particular, it is possible that a new type of tax insurance policy might arise, whereby an insurer indemnifies a business's entire tax exposure in exchange for a (probably sizable) fee. Because such a general tax insurance policy would not be limited to a specific transaction or tax position, it would not be essentially equivalent to a pre-enforcement challenge.

A. Tax Insurance, a Primer

What is tax insurance? In short, it is an insurance policy that covers tax liabilities. A garden-variety insurance policy requires the insured to pay a fee to the insurer (usually called a "premium") in exchange for an

189. Givati, *supra* note 185, at 156–63.

190. *See supra* Part II.

indemnity to compensate the insured for certain losses, subject to certain conditions and limitations.¹⁹¹ The magnitude of the premium will generally be proportional to the size of the expected loss (*i.e.*, to the uncertain tax liability), the chances that the loss will occur, and the economic effect of any conditions and limitations contained within the policy. Just as an automobile insurance policy might cover prospective hail damage or injury caused by a careless driver, a tax insurance policy pays the taxpayer for certain pre-described liabilities owed to the IRS, plus interest and penalties. And just as it is unclear when a driver purchases auto insurance that a hailstorm will damage her car, so too, it is unclear when a taxpayer purchases tax insurance whether the IRS will come along and disagree with the covered tax position. In each case, the risk is shifted to the insurer.¹⁹²

Insurance policies that cover costs arising from tax audits appear to date to at least the 1980s.¹⁹³ This product—generally called “tax audit insurance”—was described by one contemporaneous article as covering the entire tax return of an individual (coverage for businesses being unavailable), and policies operated by “reimburs[ing] policyholders for tax deficiencies and, in some cases, professional fees” up to a limit of \$100,000.¹⁹⁴ Penalties and interest were generally excluded from coverage, as were transactions without economic substance and certain other carve-outs.¹⁹⁵ Thus, while tax audit insurance’s coverage was quite circumscribed in some respects—subject to a cap and limited only to the core tax deficiency—it was in a very important respect quite broad,

191. As the Court explained in an unusual paean to the insurance industry, “[t]he modern insurance business holds a commanding position in the trade and commerce of our Nation. Built upon the sale of contracts of indemnity, it has become one of the largest and most important branches of commerce.” *United States v. South-Eastern Underwriters Ass’n*, 322 U.S. 533, 539–40 (1944) (holding that insurance is “commerce” for purposes of the Commerce Clause).

192. In the words of one broker, tax insurance “help[s] taxpayers sleep better at night.” Jon Hutchens, *M&A Tax Risk on the Rise: Inside the Hot Market for Tax Liability Insurance*, MOSAIC INS. (July 30, 2024), <https://www.mosaicinsurance.com/resources/insights/~ma-tax-risk-on-the-rise-inside-the-hot-market-for-tax-liability-insurance/> [<https://perma.cc/Q5F8-Y7CU>].

193. See Foster, *supra* note 14, at 499.

194. William D. Popkin, *Taxing Personal Insurance: The Case of Tax Audit Insurance*, 4 VA. TAX REV. 379, 379–80 (1985); see also Richard L. Doernberg, *Some Thoughts on Tax Audit Insurance*, 17 CONN. L. REV. 541, 541, 544 (1985) (noting that a type of audit insurance “indemnifies a taxpayer for any additional tax liabilities up to \$100,000 arising out of an IRS examination of the insured return”). In 2026 dollars, the cap applicable to tax audit insurance comes to about \$310,000. *CPI Inflation Calculator*, U.S. BUREAU OF LAB. STATS., https://www.bls.gov/data/inflation_calculator.htm [<https://perma.cc/S9BM-CDZW>] (last visited Mar. 17, 2026) (finding that \$100,000 as of January 1985 is equivalent to \$309,748.82 as of February 2026). This is presumably enough to satisfy the outstanding tax deficiencies of all individual taxpayers but the very wealthy.

195. Popkin, *supra* note 194, at 380.

covering any liability that could arise on the covered taxpayer's income tax return. That is, the insurance policy would indemnify the taxpayer for any transaction or position taken in the covered taxable year that could result in tax liability on the same return. We will return to this point in more detail later on.¹⁹⁶

Contemporary tax insurance differs from tax audit insurance in several ways, but the difference most in need of emphasis is that the former typically covers only one transaction or position (or a cluster of intimately related transactions or positions).¹⁹⁷ Tax insurance covers tax liabilities arising out of specific transactions or specific issues on a return, not the taxpayer's entire return or every issue implicated by that return. In contrast to tax audit insurance, contemporary tax insurance policies are bespoke, crafted to the specific legal framework applicable to the transaction and the specific facts raised by it.¹⁹⁸ Because a tax insurance policy is confined to the tax liability arising from the covered issue, policies generally terminate after about seven years, that is, when the statute of limitations with respect to the covered issue expires, plus a cushion.¹⁹⁹ The feature common to all policies is that the taxpayer may recover from the insurer when the taxpayer's position is not sustained by the IRS or a court, typically including interest and penalties.

Policies are also customized economically. Many policies typically include a "retention"—"that is, a deductible."²⁰⁰ As with many consumer insurance products, a taxpayer that purchases tax insurance must typically cover certain losses before the insurance benefit kicks in. With tax insurance, however, the retention "is generally limited to defense and contest costs," and thus "represents the taxpayer's cost of defending its tax position regardless of the procurement of a tax insurance policy."²⁰¹ On the flip side, policies typically include a benefit limit or cap, beyond which insurers will not pay.²⁰² The policy cap is necessary because, while

196. See *infra* Section III.C.

197. See James Gray & Alexios Hadji, *Tax Insurance: Another Tool for Your Transaction Toolbox?*, 25 INT'L TAX REV. 37, 38 (2014) ("[T]he scope of the tax loss or tax event—the loss or event for which coverage is being provided—is a key policy element to be negotiated."); Jordan Tamchin, Matt Movafaghi, Scott Harty & Michael Saitta, *Tax Insurance: An Agent of Change: It's on the Front Burner These Days*, 75 TAX EXEC. INST., Jan./Feb. 2023, at 50, 52.

198. See Gray & Hadji, *supra* note 197, at 38 ("During the diligence stage, the insurer also works to draft a policy to match the requested coverage and the specific terms of the policy will be negotiated.").

199. See Shans, *supra* note 7, at 37 ("[B]ecause policy terms generally allow for claims to be made for seven years (or more, depending on the context), tax insurance provides taxpayers with protection throughout the entire tax statute of limitations.").

200. *Id.*

201. *Id.*; see Logue, *supra* note 3, at 388.

202. See Matthew Movafaghi & Jordan Tamchin, *A Tax Practitioner's Guide to Tax Insurance*, 172 TAX NOTES FED. 201, 203 (2021).

the underlying tax liability can be calculated at the time the policy is bound, the policy covers other expenses associated with a tax contest, meaning the aggregate costs associated with the insured position could be higher, in many cases much higher. The required premium payment derives primarily from the strength of the covered tax position, as well as the retention and the cap. That is, as (1) the position becomes weaker (*i.e.*, less likely to be sustained), (2) the retention becomes lower, or (3) the cap becomes higher, up goes the premium. Overall, policy limits can be in the billions of dollars, with premiums usually falling around 5 percent of the policy limit.²⁰³

Apart from these bespoke economic terms, tax insurance policies also usually feature a host of common terms.²⁰⁴ For example, taxpayers applying for a tax insurance policy must comply with certain underwriting terms, including paying a fee to cover the cost of underwriting.²⁰⁵ Claims under the policy accrue when the taxpayer receives a notice (such as a notice of deficiency) that the insured position is invalid, or otherwise receives a request from the IRS to extend the statute of limitations with respect to the position.²⁰⁶ The taxpayer is often required to supply a tax opinion (or memorandum) from an outside advisor at a certain level of comfort regarding the reasonableness of the position, as well as underlying financial statements and other supporting documents.²⁰⁷ Proceeds from the insurance policy are typically paid out only after a tax contest is finally resolved (either by a court or through settlement with the insurer's consent), and the policy covers virtually all losses associated with the position and contest, including additions to tax, penalties, interest, and contest costs (all net of the retention).²⁰⁸ One small

203. See Field, *supra* note 3, at 1193 nn.74–78 (collecting authorities for the proposition that limits can rise to up to \$2 billion and premiums amount to a single-digit percentage of the limit).

204. For an overview of common terms, see Jeffrey M. Lash, Justin Pierce Berutich, Bryce R. Pressentin, Kyle Reiter & Sydney Lodge, *Inside the Black Box: An Underwriter's Perspective on Tax Insurance*, 104 TAX NOTES STATE 29, 30–31 (2022).

205. See David S. De Berry, Hartford, Comment Letter on Temporary Regulation 1.6011-4T (Dec. 2, 2002) [hereinafter De Berry Letter] (describing the conservative underwriting process); Lash, Berutich, Pressentin, Reiter & Lodge, *supra* note 204, at 31 (noting that taxpayers “pay a nonrefundable underwriting fee at the start of formal underwriting”).

206. Lash, Berutich, Pressentin, Reiter & Lodge, *supra* note 204, at 31.

207. See Shans, *supra* note 7, at 37. Of course, the higher the level of comfort that the outside advisor gives, the more favorable economic terms the insurer might be willing to give to the taxpayer. See Lash, Berutich, Pressentin, Reiter & Lodge, *supra* note 204, at 32.

208. See Lash, Berutich, Pressentin, Reiter & Lodge, *supra* note 204, at 31. Payment is contingent on certain conditions being met, namely that the taxpayer did not defraud the insurer, make a material omission or misstatement to the insurer, take a position on the taxpayer's return other than the insured position, or settle the contest without the consent of the insurer, and certain change-of-law conditions. See *id.*

point that will become significant in Part IV: Tax insurance policies virtually always include a gross-up on proceeds in the event the receipt of proceeds is taxable income to the taxpayer.²⁰⁹ That is to say, if the taxpayer's receipt of an indemnity payment from the insurer is itself taxable income, the insurer will pay the incremental tax.

After summing its parts, the whole of a tax insurance policy is a financial product that insulates the taxpayer from ex ante tax risk because it covers all the costs associated with a failed tax position. Preparer warranties cover only the costs of audit,²¹⁰ advisor warranties provide a money-back guarantee,²¹¹ and tax opinions insulate the taxpayer from penalties (as well as providing for a malpractice action).²¹² But tax insurance policies, if collected, generally pay the underlying tax liability *plus* penalties and interest, if any. Assuming the taxpayer seeks a policy with a limit high enough to cover the anticipated exposure (plus penalties and interest) as well as a gross-up, a taxpayer whose position is not sustained by the IRS is placed in the same economic position it would have been in had the position been sustained.

In addition, tax insurance has advantages over both traditional tax indemnities and PLRs. Tax indemnities operate between the parties to the transaction.²¹³ This means, in the first place, that the indemnity works only in a deal context; tax insurance, on the other hand, can be purchased by a single taxpayer for virtually any tax issue, whether or not that issue arises out of a transaction.²¹⁴ Additionally, tax indemnities do not dislocate the tax risk from the transaction; they merely shift the risk to another transaction party. But if the indemnifying party cannot stomach the entirety of the tax risk implicit in the transaction (as is often the case, especially in an economy like ours in which private equity dominates), one of two results will follow: The transaction will fall apart or the indemnified party will have to settle for less than a full indemnity. Tax insurance solves this conundrum by shifting the risk not to another party in the transaction, but to a third party (the insurer) for a fee. Like all insurers, the provider of a tax insurance policy is willing to take the risk

209. See *id.*; Shans, *supra* note 7, at 37; Movafaghi & Tamchin, *supra* note 202, at 203; Gray & Hadji, *supra* note 197, at 38; Tamchin, Movafaghi, Harty & Saitta, *supra* note 197, at 52; Logue, *supra* note 3, at 388; Kahn, *supra* note 23, at 9; Field, *supra* note 3, at 1186 n.35, 1193; Foster, *supra* note 14, at 477.

210. See *supra* text accompanying note 142.

211. See *supra* text accompanying note 145.

212. See *supra* Section II.B.

213. See *supra* Section II.C.

214. For example, one common issue insured by tax insurance policies is S corporation status. See, e.g., Movafaghi & Tamchin, *supra* note 202, at 205 n.27; Tamchin, Movafaghi, Harty & Saitta, *supra* note 197, at 52. If a corporation flunks S corporation status, it will owe taxes as a C corporation. See I.R.C. §§ 1361(a)(2), 1363(a). For a discussion of the incapacity of indemnities to address this tax risk, see *supra* notes 166–69 and accompanying text.

because the premium charged permits the provider to pool risks with other unrelated transactions. Tax insurance achieves what the simple tax indemnity cannot: shifting tax risk away from the parties entirely.²¹⁵ And tax insurance presents few of the problems that arise when considering a PLR.²¹⁶ Tax insurance policies can be procured quickly, and purchasing a policy does not increase the risk that the taxpayer will be audited. And whereas the IRS has affirmatively determined not to rule on many topics,²¹⁷ the list of tax issues on which insurers are willing to provide tax insurance is growing.²¹⁸ In theory, any tax issue could be covered under an insurance policy.

For the foregoing reasons, tax insurance effectively eliminates ex ante tax risk as far as the taxpayer is concerned. But this raises an important question: If pre-enforcement challenges were available to taxpayers—as they are to other regulated parties—would they accomplish the same goal?

B. Tax Insurance as a Pre-Enforcement Challenge

The answer is yes, and it reveals why tax insurance functions as a synthetic pre-enforcement challenge. Were the AIA not the law of the land, pre-enforcement challenges by taxpayers *also* would effectively eliminate ex ante tax risk. Given similar costs and benefits that arise between both pre-enforcement challenges and tax insurance, this Section argues that the two are economically equivalent. In other words, tax insurance provides a kind of synthetic, privatized pre-enforcement challenge to taxpayers.

Before describing the rationale of this claim, it is first worth pausing to note that the claim is not as nonintuitive as it might first sound. To see this, consider the relationship of PLRs to both pre-enforcement challenges and tax insurance. It is commonplace in the literature on tax

215. See Kahn, *supra* note 23, at 7 (“Instead of shifting liability risks between contracting parties, such as a buyer, seller, or broker, tax insurance shifts the tax uncertainty risk as to the consequences of a transaction to a neutral third party for a fee.”).

216. See *supra* Section II.D.

217. See *supra* Section II.D; Cauble, *supra* note 179, at 525–26.

218. See *infra* Section III.C.

insurance—both industry literature²¹⁹ and academic literature²²⁰—to note the similarities of tax insurance and PLRs. For example, James Gray and Alexios Hadji have stated plainly that “[t]ax insurance can . . . act as an effective private-market substitute against tax risks for which the government previously provided insurance in the form of private rulings.”²²¹ The connection also holds between PLRs and pre-enforcement challenges. Like a final judgment from a court or a settlement with the IRS, “taxpayers can achieve legal certainty regarding the tax consequences of contemplated transactions” by using PLRs.²²² The economic benefit arising from each might ultimately require subsequent litigation, such as through an enforcement action,²²³ but the economic effect is the same: From the taxpayer’s perspective, there is no question as to, or economic consequence arising from, the tax treatment of the proposed transaction, so therefore the economic consequences to the taxpayer are clear. If PLRs are economically similar to both pre-enforcement challenges as well as tax insurance, then (by the transitive property) pre-enforcement challenges and tax insurance are similar to one another.

But the similarity goes beyond high-level reasoning like this. A pre-enforcement challenge—were it available to a taxpayer²²⁴—would present a certain bundle of economic costs and benefits. Those costs and benefits parallel the costs and benefits that redound to a taxpayer that purchases tax insurance. For purposes of the following, this Article sets to the side

219. See, e.g., Shans, *supra* note 7, at 37 (“[A]lthough not providing the same comfort level as a private letter ruling, by making a taxpayer financially whole, tax insurance provides the same financial protection.”); Movafaghi & Tamchin, *supra* note 202, at 201 (“Although a private letter ruling provides assurance from the IRS on the tax implications of a transaction, one cannot be sought for every issue, and the process to obtain a letter ruling is often lengthy and uncertain. Tax insurance bridges those gaps by providing financial certainty on a tax issue in a matter of days.”); De Berry Letter, *supra* note 205, ¶¶ 6, 8 (“Tax insurance provides a needed alternative to the expenses, limitations and uncertainties associated with private letter ruling requests” and thus “fills the ‘gap’ caused by the cost, limitations, uncertainties and delays associated with private letter rulings.”).

220. See, e.g., Field, *supra* note 3, at 1192 (noting that while “PLRs bind the IRS and guarantee the *tax treatment*”—which insurance cannot provide—“insurance guarantees the *economics*, which is sufficient certainty for some taxpayers”); Foster, *supra* note 14, at 478 (describing certain consequences “when a business procures tax insurance instead of seeking a private letter ruling”).

221. Gray & Hadji, *supra* note 197, at 37.

222. Givati, *supra* note 185, at 147.

223. Presumably, the IRS would not be so cavalier as to disregard a court order, a valid settlement, or a validly issued PLR.

224. Because of the AIA, we have precious few examples of pre-enforcement challenges, so the analysis that follows is largely hypothetical. Indeed, to the extent it is applicable to an ordinary tax liability—not a reporting requirement with attendant penalties, as was presented in *CIC Services, LLC v. IRS*, 141 S. Ct. 1582, 1594 (2021)—this is entirely hypothetical as it applies to the tax context.

the case of a pre-enforcement challenge decided in favor of the government (either on the merits or on some other basis) and that fails to settle. That is because the taxpayer is unlikely to engage in the transaction or behavior that would give rise to tax following an unsuccessful pre-enforcement challenge. The pre-enforcement challenge will have alerted the Service to the possibility of a tax liability, and the judgment in favor of the government (if decided on the merits) will, as a practical matter, preclude the taxpayer from challenging that tax treatment in later litigation.²²⁵

So, what benefits and burdens does a taxpayer encounter after a successful pre-enforcement challenge? The benefits are relatively clear: The taxpayer receives an injunction against the IRS from collecting more tax than is legally appropriate or a declaration of the correct tax treatment of the position. Although slightly different because it did not implicate an underlying tax liability, *CIC Services* illustrates the hypothetical quite well. After the Supreme Court held that *CIC Services*' suit was not barred by the AIA,²²⁶ the case was ultimately remanded to the District Court for the Eastern District of Tennessee, and the parties eventually cross-moved for summary judgment on the merits.²²⁷ The district court held that the IRS notice at issue was invalid on the basis of a Sixth Circuit precedent.²²⁸ Accordingly, the court entered a judgment vacating the notice²²⁹ and requiring the IRS to return any documents produced by *CIC Services* pursuant to the notice.²³⁰ As a result, no tax or penalties arising from failure to comply with the notice were paid.

On the other side of the ledger, the costs of bringing a pre-enforcement challenge are also fairly clear: legal fees. These will vary widely, scaling up based on the law firm hired (or whether the taxpayer

225. For example, if the pre-enforcement challenge were decided on the merits in favor of the government, the taxpayer undertook the transaction, the IRS audited the taxpayer and asserted the tax, and then the taxpayer filed a petition in Tax Court, presumably the issue of the proper tax characterization would be barred by issue preclusion, and the Tax Court would resolve the petition in favor of the IRS. See *B&B Hardware, Inc. v. Hargis Indus., Inc.*, 575 U.S. 138, 148 (2015).

226. *CIC Servs., LLC*, 141 S. Ct. at 1594.

227. See *CIC Servs., LLC v. IRS*, 592 F. Supp. 3d 677, 680 (E.D. Tenn. 2022).

228. *Id.* at 683 (citing *Mann Constr. v. United States*, 27 F.4th 1138, 1143–46 (6th Cir. 2022)).

229. If the pre-enforcement challenge were based on the APA, it is possible that a successful challenge could result in universal vacatur and thus benefit other parties. That is because the Supreme Court has yet to resolve the meaning of “set aside” in 5 U.S.C. § 706(2). If the challenge is brought under some other cause of action, such as an *Ex parte Young* challenge, then likely any relief would be confined to the taxpayer only. See *Trump v. CASA, Inc.*, 145 S. Ct. 2540, 2540 (2025) (holding that universal injunctions are not authorized by the Judiciary Act of 1789). In any event, the result would be the same with respect to the taxpayer who brought the pre-enforcement challenge.

230. *CIC Servs., LLC*, 592 F. Supp. 3d at 688.

is lucky enough to receive pro bono representation), the complexity of the subject matter, and certain contingencies of litigation, such as what motions are filed or what discovery is required. Needless to say, the legal expenses associated with bringing a pre-enforcement challenge to its conclusion could be substantial. The taxpayer might seek to recover some of these costs under the Equal Access to Justice Act (EAJA);²³¹ however, attorneys' fees are usually limited to \$125 per hour, with some flexibility for special circumstances.²³² But oftentimes, EAJA fees are not awardable, particularly if the government's position meets the low bar of being "substantially justified," which means it had a "reasonable basis in law and fact."²³³ The *CIC Services* saga is also instructive here. After succeeding at the Court and on the merits in the district court, CIC Services moved for attorneys' fees under EAJA in an amount equal to about \$230,000.²³⁴ Even though the district court had ruled that the IRS action in promulgating the notice had been arbitrary and capricious,²³⁵ the magistrate judge recommended (and the district court adopted) the view that the IRS's position had nevertheless been substantially justified and denied EAJA fees on that ground.²³⁶ Taxpayers bringing hypothetical pre-enforcement challenges would therefore likely expect to absorb the litigation costs associated with their challenge.

The economics are fundamentally the same for a taxpayer that acquires tax insurance. That is primarily because tax insurance covers the tax treatment of a specific issue or transaction. If an insured taxpayer undertakes the covered transaction, does not pay the uncertain tax amount, and the IRS never audits the position, then the statute of limitations will typically lapse prior to the expiration of the policy. As a result, the taxpayer receives the economic benefit of not needing to pay the tax amount that was uncertain—exactly the same result as if the taxpayer had brought a successful pre-enforcement challenge. A similar result arises if the IRS *does* audit and challenge the position prior to expiration of the statute of limitations. In that case, the tax insurance policy kicks in, generally paying (after the retention is met) contest expenses, the underlying tax deficiency, and any interest, penalties, or additions to tax payable on that deficiency.²³⁷ The same principle would apply whether the contest is resolved by court order or settlement with

231. 5 U.S.C. § 504; 28 U.S.C. § 2412.

232. 5 U.S.C. § 504(b)(1)(A).

233. *Pierce v. Underwood*, 487 U.S. 552, 566 & n.2 (1988).

234. *See CIC Servs., LLC v. IRS*, No. 17-cv-110, 2023 WL 6457224, at *4 (E.D. Tenn. July 12, 2023).

235. *CIC Servs., LLC*, 592 F. Supp. 3d at 687.

236. *See CIC Servs., LLC v. IRS*, No. 17-cv-110, 2023 WL 5821768, at *3–4 (E.D. Tenn. Sep. 8, 2023).

237. *See supra* Section III.A.

the IRS. Again, the taxpayer finds themselves in the same situation as if they had brought a pre-enforcement challenge and won.

Tax insurance is not without costs, however, and these are all similar to the litigation expenses that the taxpayer would incur in a pre-enforcement challenge (and that would be difficult to recoup under EAJA). As previously described, just to acquire a tax insurance policy, a taxpayer will need to pay the insurance premium, in addition to any underwriting fees and the fees associated with producing an advisor opinion about the reasonableness of the underlying tax position.²³⁸ And if the IRS does challenge the insured tax position, the taxpayer will be required to pay the contest costs up to the retention limit; to that extent, the cost of tax insurance is simply a litigation expense.

There are two respects in which tax insurance could be economically distinguished from a pre-enforcement challenge, but neither changes the fundamental economic similarity. First is pricing. It is not necessarily the case that the costs endured by a taxpayer that purchases tax insurance will be the same as those endured by a taxpayer that brings a pre-enforcement challenge (were it available). For one, the costs are different: The costs of a pre-enforcement challenge are largely based on legal fees, and the cost of insurance is spread across the premium, retention, fees associated with producing a tax opinion, and any costs incurred that are above the policy limit.²³⁹ In particular, some of the costs entailed by tax insurance—such as the premium, retention, and costs above the policy limit—are tied to the magnitude of the tax exposure and the strength of the position taken.²⁴⁰ By contrast, legal fees associated with a pre-enforcement challenge presumably do not scale with the magnitude of the underlying tax exposure, although legal fees might increase if the position is not particularly strong under settled law or is particularly factually complex. Taken together, this all means that costs might diverge significantly between insurance and pre-enforcement challenges.

This is purely a pricing problem, and it is one that will exist even if the taxpayer confines itself to one method of risk reduction. For example, if the taxpayer were to pursue a pre-enforcement challenge, it would need to select legal representation, and legal fees can diverge wildly.²⁴¹ Yet,

238. See *supra* Section III.A.

239. See *supra* Section III.A.

240. In other words, a transaction that could result in \$5 million in tax will not have the same premium, retention, or limit as a transaction that could result in \$50 million in tax.

241. See generally Gillian K. Hadfield, *The Price of Law: How the Market for Lawyers Distorts the Justice System*, 98 MICH. L. REV. 953 (2000) (surveying prices for legal services); *How Much Does a Lawyer Cost?*, METLIFE (Oct. 18, 2022), <https://www.metlife.com/stories/legal/how-much-do-lawyers-cost/> [https://perma.cc/6H63-P3WC] (describing different frameworks lawyers use to charge clients).

we would never say that because a taxpayer selected an expensive lawyer over a less expensive one that the fundamental economics of the pre-enforcement challenge have changed. Similarly, a taxpayer seeking tax insurance can select from many different insurance companies, some of which might provide more favorable prices. In sum, the fact that a hypothetical pre-enforcement challenge might be more or less expensive than a tax insurance policy does not establish that the two present fundamentally different economics to a taxpayer.

Second, there are risks that are not shared between pre-enforcement challenges and tax insurance. Pre-enforcement challenges raise the risk of inconsistent government action. That is, the success of the pre-enforcement challenge turns on the amenability of the adjudicator to conclude that the taxpayer's position is indeed the right treatment under the law. But judges can be inconsistent,²⁴² and the economics of a favorable ruling accrue entirely to the taxpayer, as do the economics of an unfavorable ruling. In addition, the case might be disposed of by settlement prior to final adjudication; in that case, the taxpayer is subject to a similar risk, but the inconsistency is tied to the IRS employee overseeing the litigation. A taxpayer with tax insurance is insulated from these risks because the costs of a negative ruling or unfavorable settlement are (if the policy limit is high enough) borne entirely by the insurer. While this might seem to be a significant difference between pre-enforcement challenges and tax insurance, the downside risk that the taxpayer absorbs in the pre-enforcement challenge context can be offset with the option not to engage in the transaction at all, which cannot be the relevant comparator to tax insurance.

On the other side of the ledger, tax insurance exposes the taxpayer to solvency risk associated with the insurance company. Specifically, the taxpayer is insulated from the underlying tax consequences of a tax contest only if the insurance company has the capacity to pay the claim. Taxpayers that file pre-enforcement challenges are not exposed to this risk because, needless to say, they have not outsourced the *ex ante* tax risk to anyone. This solvency risk, however, is a small one. Because insurance companies are critically important to the nation's economy, they tend to be subject to heightened regulation and are a "safe" form of insurance.²⁴³ In addition, insurers and other underwriters have gobbled up sophisticated tax counsel to help them price the risk of policies, allowing them to spread risk more evenly across various policies.²⁴⁴ Finally, as the tax insurance industry has matured, insurance companies have been able to shift risk through reinsurance contracts to other

242. Anthony Niblett, *Tracking Inconsistent Judicial Behavior*, 34 INT'L REV. L. & ECON. 9, 9 (2013).

243. See *infra* Section III.C.

244. See Field, *supra* note 3, at 1199.

insurance companies, meaning that the taxpayer is in a sense diversified with respect to its policy.²⁴⁵ The author is not aware of any tax insurance policy that has failed to pay out on the grounds of insolvency. Thus, while solvency risk is present in tax insurance contracts, it does not appear to factor largely into the economic profile of tax insurance.

For the foregoing reasons, the basic economic deal presented by both tax insurance and pre-enforcement challenges is the same from the perspective of taxpayers.²⁴⁶ Taxpayers will bear certain costs directly—litigation expenses, premiums, retentions, and so forth—but in any event, they will not bear the downside consequence of a failed tax position. If the pre-enforcement challenge fails, they need not complete the transaction; if it succeeds, the tax will not be payable; and if they obtain insurance with an appropriate policy limit, the insurance company (and its reinsurers) will absorb the cost. In this respect, tax insurance should be understood as a kind of privatized, synthetic pre-enforcement challenge.

C. The Changing Tax Insurance Marketplace

Owing to its usefulness, tax insurance has exploded over the last decade, becoming a common tool in the toolkits of sophisticated

245. De Berry Letter, *supra* note 205, ¶ 9 (discussing the underwriting requirements of “insurance carriers and their respective reinsurance carriers”); Logue, *supra* note 3, at 387 (“[W]hen a tax insurance policy is purchased, certain tax risks are transferred to an insurance company, which then pools and distributes the risks across its other insureds and which sometimes reinsures some portion of those risks with other insurance companies.”).

246. The analysis here has focused on the equivalency of tax insurance and pre-enforcement challenges solely from the perspective of the taxpayer, but it has ignored the perspectives of the IRS and the insurer. That is because, from those perspectives, tax insurance and pre-enforcement challenges are not equivalent. See *supra* note 22. Setting the perspective of the government to the side is justified here because tax insurance represents an improvement over pre-enforcement challenges. If a taxpayer files a pre-enforcement challenge and wins, the government collects no revenue; if the taxpayer loses, it is unlikely to transact at all, or will engage in a different transaction, meaning the government raises no, or less, revenue. But if the taxpayer secures tax insurance and the government wins on audit, the government gets paid (by the insurer). Setting the perspective of the insurance company to the side may also make sense. Although the insurance company is worse off when it pays out under a policy than if the taxpayer had filed a pre-enforcement challenge (because the insurer has no stake whatsoever in the pre-enforcement challenge), the taxation of insurance companies typically diverges significantly from the taxation of their counterparties. See, e.g., I.R.C. § 451(c)(4)(B)(ii) (providing for different accounting methods applicable to “insurance premiums”); *id.* § 811 (describing accounting methods for insurance companies). This frequently leads to tax mismatches between insurance companies and their counterparties, such as where a premium payment is deductible to the insured but generates no income to the insurance company. For this reason, in addition to the insurer’s ability to assume and spread risk, the economic deal to the insurer is not necessarily probative of the economic deal to the taxpayer.

American taxpayers and their advisors.²⁴⁷ This Section discusses three recent developments in the tax insurance marketplace and their causes: (1) the increase in size of tax insurance policies, (2) the increase in variety of issues insured, and (3) a growing awareness in the market that tax insurance is a “safe” form of insurance. While each of these changes is ultimately one of degree, if taken to their logical conclusion, they could coalesce into a new kind of tax insurance product that covers a taxpayer’s general tax liabilities, not the liability with respect to a specific issue or transaction. Such a general insurance policy would *not* amount to a synthetic pre-enforcement challenge.

Over time, the dollar value of insured tax risks and the number of policies has significantly increased. According to one estimate, whereas about 500 tax insurance policies were placed in 2015, about 6,000 policies were placed in 2021.²⁴⁸ The trend has continued since. One insurer, for example, bound around ten policies per quarter in 2021, but in the first two quarters of 2024 bound around eighty.²⁴⁹ The overall insurable amount on these policies has swelled. About twenty years ago, insurance “limits in the tens of millions [were] more common,”²⁵⁰ but now the market has capacity to absorb up to \$1 billion with respect to a given tax risk.²⁵¹ Both of these developments are likely mostly attributable to the fact that insurers are flocking to the tax insurance space.²⁵²

In addition, insurers are extending coverage to a wider variety of tax risks.²⁵³ Whereas S corporation status, renewable energy credits, REIT status, and tax-free acquisitions have been the bread and butter of tax insurance policies, insurers are now insuring (among others) trust and

247. See generally Field, *supra* note 3, at 1186–87 (describing the growth in the domestic tax insurance market since the mid-2010s). Growth is also occurring abroad. LOCKTON, MARKET AND TRANSACTIONAL RISK UPDATE (2024), https://lockbox.lockton.com/m/549c0ccbafe4c0a/original/3603122_PECAP_Tax-Liability-Market-Update_v3.pdf [<https://perma.cc/2MXA-6GWZ>] (describing the growth in the foreign tax insurance market despite a market downturn in 2023).

248. Tay, *supra* note 2.

249. Justin Berutich, *Taking Stock of the Tax Insurance Market*, EUCLID TRANSACTIONAL (July 11, 2024), <https://euclidtransactional.com/taking-stock-of-the-tax-insurance-market/> [<https://perma.cc/CH5C-XEV5>].

250. Logue, *supra* note 3, at 388.

251. MARSH, TAX INSURANCE: A COMPREHENSIVE AND COST-EFFECTIVE RISK MANAGEMENT SOLUTION 2 (2021), <https://www.marsh.com/content/dam/marsh/Documents/PDF/US-en/tax-insurance-solution.pdf> [<https://perma.cc/9JSB-CKYZ>].

252. See Shans, *supra* note 7, at 35; Tamchin, Movafaghi, Harty & Saitta, *supra* note 197, at 54 (“And as a result of the increase in the insurers, policy prices generally have come down.”).

253. See Scott Harty & Steven Penaro, *Growing Risks Are Fueling Tax and Litigation Insurance Markets*, BLOOMBERG L. (Dec. 18, 2023), https://www.bloomberglaw.com/bloomberglawnews/us-lawweek/XDTAAA3O000000?bna_news_filter=us-law-week#jcite.

estate issues, state tax issues, inversions, and transactions that have tax effects in multiple jurisdictions.²⁵⁴ Two areas deserve additional mention. In special circumstances, some tax insurers have been willing to take on what are referred to as “live risk” policies.²⁵⁵ These are policies with respect to specific tax issues that have already been identified by a particular taxing jurisdiction.²⁵⁶ Live risk policies pose a special problem for the insurance company because the losses are more certain—they cannot be discounted for audit detection. Although no public data exists, premiums paid for live risk policies are probably meaningfully higher than a typical tax insurance policy. In addition, insurance companies have become more interested in insuring valuation issues.²⁵⁷ While there is not much data on what sorts of valuation issues insurers might find attractive, one can easily imagine insurers seeking to insure, say, transfer pricing arrangements.²⁵⁸

Finally, Foster has provided evidence that tax insurance policies are relatively “safe” investments for insurers.²⁵⁹ Many tax positions are unlikely to be challenged because the taxpayer will never be audited.²⁶⁰ But when positions are identified and challenged, most insurance claims end up being for defense costs, not for payments of the underlying tax liability, interest, or penalties.²⁶¹ Claims are often settled with the relevant taxing authority, and to date, it appears that there has never been a significant litigation between a taxpayer and its insurer over a tax insurance policy.²⁶²

Some portion of the expansion of the tax insurance market is undoubtedly due to circumstantial changes in law. For example, the Inflation Reduction Act of 2022 (IRA)²⁶³ enacted new Code provisions allowing third parties to purchase energy-related tax credits from energy producers, thus opening up new types of transactions that might merit insurance.²⁶⁴ In addition, the IRA increased the Service’s budget by roughly \$80 billion over the course of ten years, with the lion’s share of

254. Tamchin, Movafaghi, Harty & Saitta, *supra* note 197, at 52.

255. *Id.*

256. *See id.*

257. *Id.*

258. *See* Shans, *supra* note 7, at 37.

259. *See* Foster, *supra* note 14, at 510.

260. *Id.* at 516–17, 517 n.237.

261. *Id.* at 510.

262. *Id.* at 510 & nn.204–07.

263. Inflation Reduction Act of 2022, Pub. L. 117-169, 136 Stat. 1818.

264. *See* I.R.C. § 6418. The so-called One Big Beautiful Bill rolled back or limited many of the energy credits that were eligible for transfer under § 6418. *See* One Big Beautiful Bill Act, Pub. L. 119-21, § 70512, 139 Stat. 72, 252–70 (2025) (restricting and eventually terminating credits arising from the production of wind and solar power).

that amount going to increased enforcement.²⁶⁵ Taxpayer appetite for tax insurance may have grown—at least for a time—because the chances of an audit appeared to be going up. But the tax insurance market has been gaining steam for some time, with a substantial amount of it coming prior to the enactment of the IRA.²⁶⁶

A second explanation for the explosion of tax insurance might be that, over time, the market has interpreted the Service as effectively blessing tax insurance. Decision-makers at the Service have followed tax insurance for nearly two decades and failed to take decisive action against it. Early concerns that tax insurance would widely be used to insure tax shelters²⁶⁷ have not borne out.²⁶⁸ In addition, several IRS guidance documents have, over the years, supported—or at least cast doubt upon—the validity of tax insurance. For example, Revenue Procedure 2014-12 considered certain “[i]mpermissible guarantees” that could affect a partner’s status as a partner for tax purposes; in delineating what constitutes an impermissible guarantee, the IRS explained that the rule “does not prohibit the [partner] from procuring insurance from persons not involved with the . . . [p]artnership.”²⁶⁹

Indeed, if the tax insurance market continues to expand—more policies, higher limits, and for more varied tax positions—it is not beyond the realm of possibility that tax insurers may launch an altogether new product—call it “general tax liability insurance.” Whereas current market practice confines insurance claims to particular issues or transactions,²⁷⁰ a policy might be written whereby the entirety of a taxpayer’s return is insured in exchange for a higher premium. While this might seem risky for insurers, there is historical precedent. Recall that “tax audit

265. See generally § 10301, 136 Stat. at 1831–33 (appropriating funds to the IRS); Alex Muresianu, *How to Think About IRS Tax Enforcement Provisions in the Inflation Reduction Act*, TAX FOUND. (Aug. 17, 2022), <https://taxfoundation.org/blog/inflation-reduction-act-irs-funding/> [https://perma.cc/EX4P-L66P] (noting that \$45.6 billion of new IRS funding was allocated to enforcement). Congress later withdrew approximately \$20 billion of this new IRS funding. Jacob Bogage & Shannon Najmabadi, *Congress Stripped IRS of Another \$20 Billion in Government Shutdown Fight*, WASH. POST (Dec. 26, 2024), <https://www.washingtonpost.com/business/2024/12/26/irs-funding-cut-20-billion-shutdown/>.

266. See Tamchin, Movafaghi, Harty & Saitta, *supra* note 197, at 52 (noting in 2023 that the tax insurance market “really matured” in the last five years).

267. See Logue, *supra* note 3, at 395.

268. See De Berry Letter, *supra* note 205, ¶¶ 8–9 (noting that tax insurers “refus[e] to insure tax shelters”); Movafaghi & Tamchin, *supra* note 202, at 205 (“The tax insurance market does not insure aggressive transactions, tax shelters, and listed transactions.”).

269. Rev. Proc. 2014-12, § 4.05(2)(a), 2014-3 I.R.B. 415, 417; see also Rev. Proc. 2020-12, § 4.08(1), 2020-11 I.R.B. 511, 513 (noting that a restriction against guaranteed results “does not prohibit the [i]nvestor from procuring insurance, including recapture insurance,” from certain unrelated parties).

270. See *supra* Section III.A.

insurance” from the 1980s covered a taxpayer’s entire return, although it was unavailable for businesses and did not cover interest and penalties.²⁷¹ If modern tax insurance is truly a safe investment and capable of handling billion-dollar risks in odd corners of the Code, then it stands to reason that—for the right price—an insurer may be willing to write a general tax liability policy. Perhaps they already are.

Unlike a contemporary tax insurance policy, a general tax liability policy is not economically equivalent to a pre-enforcement challenge. Whereas a taxpayer bringing a pre-enforcement challenge would focus on the tax treatment of a specific transaction,²⁷² issue, or tax position—which is precisely how a typical tax insurance policy works now—a taxpayer purchasing general tax liability insurance receives de facto protection for all issues and positions. It would receive protection even for issues of which it was unaware. Whereas pre-enforcement challenges and typical tax insurance encourage taxpayers to take conservative, well-supported tax positions,²⁷³ insurers of general tax liability insurance cannot possibly hope to encourage conservative position-taking across an entire return. Indeed, general tax liability insurance policies are likely to do the opposite: encourage insured taxpayers to take ever-more aggressive positions, even to enter into tax shelters. This moral hazard may not be such a problem to the insurers themselves—after all, if they are willing to price the risk and take it on, so be it. But it does present a policy problem because ultimately unsupportable tax positions come at the expense of the fisc. That is quite the opposite of the function tax insurance now serves, which is to allow for the thoughtful resolution of hard tax problems leading to serious ex ante risks. While general tax liability insurance might never take off, a reasonable policy approach to tax insurance would be wise to discourage it.

271. See Popkin, *supra* note 194, at 379 n.1, 380.

272. The reason for this is that the injunction or declaration resulting from a pre-enforcement challenge would need to regard a specific provision of law. Short of attacking fundamental principles of income taxation (such as the definition of income in § 61, how to compute gain in § 1001, and so forth), a taxpayer could not, by means of a pre-enforcement challenge, attack the entirety of their tax liability for a given year. That is because, in the first place, the nature of a pre-enforcement challenge implies that the taxable year with respect to which the challenge has been filed has not yet closed, and second, the total tax liability will arise from the application of numerous provisions of statutory and sub-statutory law. A taxpayer bringing an APA or *Ex parte Young* challenge would need to specifically claim which provisions of law are unlawful (and why), meaning the litigation will focus on one issue (or a cluster of them), and the injunction or declaration will be narrowed to such issues.

273. De Berry Letter, *supra* note 205, ¶ 8 (“[T]he tax insurance industry injects a distinctly conservative evaluation within the community of tax professionals and helps to cultivate a culture of compliance . . .”).

IV. THE FUTURE OF TAX INSURANCE

As flourishing as the tax insurance market may be, the future of tax insurance is currently being contested. Criticisms that tax insurance might provide cover for bad behavior—like tax shelters—has not borne out, but commentators are now suggesting that tax insurance be harnessed to help with tax administration. This Part begins by addressing two of these proposals—giving preferential treatment to conservative insurers and mandating the purchase of insurance for certain tax positions—and arguing that they could harm the availability of tax insurance. This would be a bad result. Through the AIA, Congress has already established a tax system that strands taxpayers with *ex ante* tax risk—in contrast to most regulated parties—and tax insurance is a sensible, market-based response that provides to taxpayers a synthetic pre-enforcement challenge. Disadvantaging tax insurance would thus put taxpayers at a double disadvantage with respect to general principles of administrative law.

Instead, Congress should seek to protect and promote tax insurance, although in doing so it might sand off some rough edges. The simplest way to do this is—ironically—to clarify the tax consequences of a tax insurance policy itself. In particular, policymakers could promote tax insurance by providing that expenses incurred to obtain tax insurance—the premium, underwriting fees, legal fees, and retention—are deductible expenses. Moreover, policymakers should clarify that a taxpayer benefitting from an indemnity under a tax insurance policy realizes no income for tax purposes. Arguably, these are already the correct treatments under law—but only arguably. Thus, these clarifications would reduce the cost of purchasing tax insurance. And they would have the added benefit of bringing the tax treatment of tax insurance into accord with the tax treatment of a pre-enforcement challenge. Policymakers should also condition favorable tax treatment on, for example, the policy not being a general tax liability policy or insuring a tax shelter.

A. Regulating Tax Insurance

Recently, proposals have been put forward that would, in brief, either give preferential treatment to insurers that insure only strong tax positions or that would require the purchase of tax insurance in certain circumstances. Each of these proposals aims at a worthwhile goal, namely, to harness the advantages of tax insurance for the better administration of the tax system. Nevertheless, each could have a harsh effect on the tax insurance market, thus making tax insurance more expensive, harder to get, and minimizing the upside it provides to

taxpayers. That could risk nullifying the benefit tax insurance provides as a synthetic pre-enforcement challenge.

Field proposes a regulatory regime in which “insurers that voluntarily commit to insuring only likely compliant positions would be treated as ‘qualified insurers’ and would effectively be deputized as ‘private sector tax enforcers.’”²⁷⁴ The model has three basic components: (1) when a taxpayer purchases an insurance policy, the taxpayer must disclose the policy to the IRS, including the position covered by the policy, the essential terms of the policy, and the potential tax exposure if the position is not sustained; (2) “insurers that behave in enforcement-enhancing ways”—such as by not committing to insure tax shelters or weak positions—and sign an agreement with the IRS could be classified as “qualified insurers”; and (3) taxpayers who purchase policies from qualified insurers could receive favorable treatment, such as lower audit rates, expedited audit timelines, and possibly compensation if the position is sustained.²⁷⁵ While there might be incidental benefits to taxpayers who purchase insurance from qualified insurers, the main purpose of the policy is to harness the unique position of tax insurers “to expand the IRS’s enforcement liabilities.”²⁷⁶

Field acknowledges that the effectiveness of this regime hinges on the Service’s ability to “separate insurers that are good private sector tax enforcers (*i.e.*, that insure only likely compliant positions) from those that are not.”²⁷⁷ In other words, the Service must not only do a good job at detecting bad positions upon examination, but also do a good job at detecting whether the taxpayer’s insurer, on the whole, is conservatively insuring positions. Even assuming that the Service can effectively draw that line, the qualified insurer paradigm might nevertheless introduce distortions into the market. In determining whether to write a specific policy, an insurer will need to determine not only whether the risk is worth taking economically, how to price it, and whether the risk can be effectively spread across multiple insurers, but also whether writing the policy could imperil the insurer’s status as a qualified insurer. Undoubtedly, some taxpayers seeking to insure a strong (but not strong enough!) position will not be able to obtain insurance from a qualified insurer. Such taxpayers will be shunted toward non-qualified insurers, if a market still exists for such policies. Conversely, if the IRS proves incapable of distinguishing between good and bad insurers, taxpayers may be incentivized to take riskier positions. That is because taking a weak position will not necessarily preclude the taxpayer from obtaining insurance with a qualified insurer, meaning that the taxpayer still reaps

274. Field, *supra* note 3, at 1189.

275. *Id.* at 1215–17.

276. *Id.* at 1185.

277. *Id.* at 1218.

the attendant benefits of such policies. In sum, even a well-crafted qualified insurer program might introduce market distortions that change the economic incentives for taxpayers and may even obstruct taxpayers from purchasing tax insurance.

Professor Michael Abramowicz has recently advocated for a reform wherein taxpayers would be required to “purchase[] a policy covering a specific aspect of the insured’s tax bill, such as valuation of a particular asset or characterization of a particular transaction.”²⁷⁸ Taxpayers who purchase such coverage would register the coverage with the IRS, thereby creating a risk pool of similar positions.²⁷⁹ The Service would then randomly select some number of taxpayers from the pool to audit.²⁸⁰ If the taxpayer’s position is not sustained, the taxpayer has no liability to the government—the insurer picks it up.²⁸¹ But to prevent strategic behavior, Abramowicz’s reform requires that penalties be proportional to the probability of detection, that is, the fewer the number of returns audited from the pool, the higher the penalty.²⁸² This mandatory insurance regime serves the purpose of tax administration by “enlist[ing] insurance companies in policing insureds” because, with such gargantuan penalties at stake, “the insurance company has no incentive to misstate the insured’s liability.”²⁸³ And because certain taxpayers would be required to purchase insurance, they would be incentivized to take less risky tax positions on pain of a high premium or not securing insurance at all.

Setting aside the question of whether Congress can affirmatively require taxpayers to purchase such insurance,²⁸⁴ Abramowicz acknowledges that mandatory tax insurance might “have greater costs than benefits” in some areas, so its application must be tailored to

278. Abramowicz, *supra* note 13, at 117.

279. *See id.* at 123.

280. *Id.* at 117.

281. *Id.*

282. *Id.* (“If an audit takes place, the government assesses the correct tax liability, assuming the remainder of the tax return is correct. Then, it calculates the difference between this amount and the amount paid by the taxpayer, and it divides this difference by the audit probability. If the resulting value is positive, then the insurer must pay this amount to the government.”).

283. *Id.* at 119.

284. Although not addressed by Abramowicz, it is unclear whether Congress would have the constitutional power to enact mandatory tax insurance. *NFIB v. Sebelius* held that the insurance mandate was not supportable by the Commerce Clause or the Necessary and Proper Clause, but only by the Taxing Clause because failure to purchase insurance entailed a tax penalty. *See* 500 U.S. 519, 520–21 (2012). So, under *NFIB*, the Abramowicz framework would likely pass muster only if failure to purchase tax insurance triggered another tax penalty. Calibrating this penalty to effectively require the purchase of tax insurance could be difficult.

particular kinds of taxes.²⁸⁵ Specifically, it appears by way of his examples that valuation questions would be the prime candidate for mandatory tax insurance.²⁸⁶ Valuation problems are particularly suitable for this kind of mandatory insurance regime because they are pure fact questions, and distinct valuations are not interrelated, so risk pools are likely to be diverse. One bad audit will not affect distinct policies. As a result, insurers can adequately spread risk across the pool. Stated more generally, mandatory tax insurance may make some sense for highly fact-bound tax risks.

But as we saw from the classical story of tax risk in Part I, not all tax risks are factual.²⁸⁷ Many are pure questions of law—such as the interaction of complex provisions of the Code and Treasury Regulations. Others, like the standards-based anti-abuse doctrines, are difficult combinations of factual and legal questions.²⁸⁸ Mandatory tax insurance for such tax issues could foist incredible risks onto the insurer; a single unfavorable court opinion on a legal issue could negatively affect many policies simultaneously, possibly bankrupting the insurance company. Thus, a mandatory tax insurance regime—if it could be crafted constitutionally²⁸⁹—would probably be limited to very narrow valuation questions, or else risk disrupting the entire industry.

B. Tax Insurance's Tax Treatment

Whither tax insurance? Since the early 2000s, the tax insurance market has ballooned, covering new issues, evermore taxpayers, and providing them a safe and reliable means of eliminating ex ante tax risk.²⁹⁰ But if policymakers interfere with the tax insurance market too much, such as by adopting reforms to harness the power of the tax insurance market for the benefit of the IRS, as some have suggested, it could harm the market and (thereby) would-be purchasers of tax

285. See Abramowicz, *supra* note 13, at 150.

286. In the final part of his article, Abramowicz applies the mandatory insurance regime to transfer pricing, wealth taxes, and sin taxes. *See id.* at 150–64. The first two of these examples are plainly valuation questions. Though less obvious, sin taxes also present valuation issues: Which behaviors are worse than others, and thus should produce a higher tax liability? It is no response to say that such questions are subjective, because all hard valuation questions are subjective. A wealth tax would be easy to apply if every type of property were easily tradeable on a liquid market, but that is not so.

287. See *supra* Section I.A.

288. See Jonathan H. Choi, *The Substantive Canons of Tax Law*, 72 STAN. L. REV. 195, 197, 201 (2020) (discussing that anti-abuse doctrines undergo both factor analysis and statutory interpretation).

289. See *supra* note 284.

290. See *supra* Section III.C.

insurance.²⁹¹ In other words, the wrong reform could stymie the development of a private mechanism to handle the economic consequences of the AIA. On the other hand, the rapid growth of the tax insurance market suggests that we might see policies covering more than just a single transaction or tax issue. These general tax liability policies are not economically equivalent to pre-enforcement challenges because—beyond tax risks arising from specific facts arising out of known transactions—they cover *all* tax risks, even unknown ones. They therefore raise considerable issues about moral hazard and (possibly) tax shelters. What should policymakers do to escape from this tax insurance trap?

Rather than heavily regulate tax insurance or mandate its purchase, Congress and the IRS can clarify the tax treatment of a tax insurance policy itself. This would not only serve the salutary purpose of clarifying the law, but a beneficial tax treatment could promote tax insurance while eschewing its more problematic varieties. That is, policymakers can have it both ways.

It is noteworthy (if not amusing) that the tax treatment of tax insurance remains uncertain. As Jeffrey Kahn noted more than fifteen years ago,²⁹² there remains confusion about how to treat premium payments and recoveries relating to tax insurance policies. While general liability insurance premiums are typically deductible,²⁹³ the Service has expressed reservations in the past about permitting deductions under §§ 162 and 212 for tax insurance premiums.²⁹⁴ In addition, recent years have seen a tense debate among scholars about whether liability insurance recovery proceeds are generally excludable,²⁹⁵ which will affect whether

291. See generally Field, *supra* note 3 (describing regulating tax insurance for the benefit of the IRS); Abramowicz, *supra* note 13 (describing mandatory tax insurance).

292. See Kahn, *supra* note 23, at 9.

293. See, e.g., Rev. Rul. 69-141, 1969-1 C.B. 48 (insurance for wrongful acts of officers); Rev. Rul. 83-66, 1983-1 C.B. 43 (medical malpractice liability insurance).

294. See I.R.S. Chief Couns. Mem. 202050015 (Nov. 9, 2020) (denying partnership deductions for premiums paid for tax insurance insuring the deductibility of charitable donations); I.R.S. Chief Couns. Mem. 202053010 (Sep. 16, 2020) (denying partnership deductions for premiums paid for tax insurance insuring a conservation easement). Whether the IRS would extend these rulings to other unusual facts is quite uncertain.

295. This uncertainty has led to a sustained debate between Professors Jeffrey Kahn and Steven Utz about the excludability of liability insurance proceeds generally, with Utz taking the position that insurance benefits are taxable unless there is an offsetting deduction and Kahn taking the view that an insurance contract represents the transfer of liability for a fair price. See Sachin S. Pandya & Stephen Utz, *Designing the Tax Treatment of Litigation-Related Costs*, 21 FLA. TAX. REV. 533, 547, 550 (2018); Jeffrey H. Kahn, *The Tax Treatment of Liability Insurance Coverage*, TAX NOTES, May 2019, at 1381, 1381; Stephen Utz, *How Insurance Recoveries Are Taxed Under the IRC*, 98 TAX NOTES STATE 607, 607–10 (2020); Jeffrey H. Kahn, *Liability Insurance: A Reply to Professor Utz*, 171 TAX NOTES FED. 423, 424 (2021).

proceeds from tax insurance policies are similarly excludable.²⁹⁶ And with respect to the excludability question, we need not turn only to scholarship to see that the issue is up for grabs—the policies themselves tell a similar story. As discussed, tax insurance policies typically contain “gross-up” provisions.²⁹⁷ That is, if the taxpayer recovers under the policy *and* the Service decides to treat that recovery as income to the taxpayer, then the insurance company will pay an additional amount such that, after income taxes are assessed on the recovery, the taxpayer ends up in the “correct” economic position. Tax insurance policies with gross-ups therefore contain a tax insurance policy within a tax insurance policy. And naturally, the policy embedded in the gross-up provision magnifies the costs to the insurer, meaning higher premiums for the taxpayer. Congress can bolster the tax insurance market—and discourage general tax liability insurance—by clarifying both ambiguities: deductibility and excludability.

First, premium payments (and by extension, other fees incurred to secure tax insurance) should be deductible. This provides an obvious and immediate benefit to the taxpayer in terms of an offset to taxable income in the year in which the policy is purchased. By reducing the economic cost of purchasing insurance, this reform would provide an incentive for taxpayers to purchase it.

For example, consider a corporate taxpayer that is seeking to ensure a \$100 million liability and is quoted a premium rate of 5 percent (*i.e.*, \$5 million). If the premium payment were deductible, the taxpayer would recoup a \$5 million deduction from gross income (on a current basis), which at current corporate rates reduces the taxpayer’s cash tax liability by \$1.05 million.²⁹⁸ So, after tax, the cost of the insurance policy declines from \$5 million to \$3.95 million, or from 5 percent of the policy limit to 3.95% of the policy limit.

This cost reduction might have one of two effects. First, if the taxpayer is especially cash-strapped, the subsidy could mark the difference between purchasing the policy or not. That would be the case where the taxpayer has, say, a \$4 million budget for a policy. And the cost reduction would be especially significant if we further assume that the taxpayer will not undertake the transaction without tax insurance. And who can blame them—a \$100 million tax exposure is immense. Thus, by bringing down costs, we would be likely to see more bound tax insurance policies. Alternatively, if the taxpayer is not especially cost-

296. See BORIS I. BITTKER, MARTIN J. MCMAHON, JR., LAWRENCE A. ZELENAK & BRUCE A. MCGOVERN, *FEDERAL INCOME TAXATION OF INDIVIDUALS* § 3.08 (2025) (expressing confusion about the absence of authority as to the exclusion of liability insurance payments).

297. See *supra* Section III.A.

298. The current corporate tax rate is 21 percent. I.R.C. § 11(b).

conscious (being able to afford an after-tax \$5 million premium), the taxpayer might increase the cap on the insurance. In that case, the taxpayer could obtain a policy with a limit of about \$126.58 million.²⁹⁹ So if taxpayers otherwise behave rationally, a world in which tax insurance premiums are deductible would likely yield more tax insurance policies, more transactions covered by tax insurance policies, larger policies, or all three.

Second, proceeds from insurance recovery should also be excluded from gross income. At first glance, this reform presents as a long-term, maybe even speculative benefit. That is, because the benefit of this policy seems to kick in only if the taxpayer becomes the subject of an IRS audit, the IRS challenges the covered position, a controversy ensues, and the IRS wins, the benefit seems to accrue in the distant future, if ever. Some or all of these events may not occur, which would probably leave the taxpayer happy and satisfied. But if they do occur, then the excludability policy would insulate the taxpayer from additional income tax owed on recovery from the insurance company.

In reality, the benefit of the excludability policy accrues to the taxpayer up front and is not speculative at all. That is because taxpayers buying standard tax insurance policies are paying an increased premium for the standard gross-up provision. An excludability policy moots the purpose of the gross-up provision, thus making the incremental cost unnecessary on the front end.

Consider our facts from before, in which a corporate taxpayer seeks \$100 million of coverage with a 5 percent fee. (Disregard the deductibility of premium payments for purposes of this exercise, as well as contest costs, retentions, and the time-value of money.) Further assume that the premium rate of 5 percent arises from the insurance company's underwriting conclusions, according to which there is a 10 percent chance the taxpayer will be audited, a 60 percent chance of success on the merits, and the insurance company's requirement for a 1 percent profit.³⁰⁰ But building in a gross-up provision will cost more than \$5 million. Assume that the risk of audit is identical (10 percent) and that the chances of success on the merits on the gross-up issue (which is

299. Assuming the nominal premium is, as we assumed above, 5 percent of the policy limit, the payment made to the insurance company would be \$6.329 million. The taxpayer would deduct this amount from their return, which at a 21 percent corporate tax rate would generate a cash tax savings of \$1.329 million. The nominal premium (\$6.329 million) less the tax savings (\$1.329 million) yields an after-tax premium cost of \$5 million.

300. The 5 percent fee arises from computing the expected cost to the insurer. Because there is only a 10 percent chance of the issue coming before the IRS and a 40 percent chance of losing upon audit, the expected payout from the insurer's perspective is \$4 million. Tacking on the 1 percent built-in profit for the insurer yields a total premium of \$5 million.

distinct as a matter of tax law from the underlying position covered by the policy) is 50 percent. The additional exposure to the insurance company arising from the gross-up issue is \$26.58 million because that is how much additionally the insurer would need to pay to account for income taxes to the insured on the recovery.³⁰¹ To account for this extra risk, the insurer would presumably increase the premium by \$1.595 million. We arrive at that number by summing the expected cost to insurer of the exposure (\$26.58 million $\times$ 10% risk of audit $\times$ 50% chance of failure = \$1.329 million) with the 1% profit associated with the additional exposure (\$26.58 million $\times$ 1% = \$266,000). Although these figures are purely illustrative, they indicate that, even at fairly low margins and mediocre assumed success rates, the gross-up provision could meaningfully add to premium payments. In this case, the gross-up increases the premium payment by nearly 27 percent.³⁰²

The IRS could initiate these policies without congressional action. In particular, with respect to the deductibility of premiums, the IRS could depart from its holdings in the Chief Counsel Memoranda previously discussed.³⁰³ And with respect to excludability, the IRS could extend the reasoning of *Clark v. Commissioner*³⁰⁴ (in which a tax preparer indemnified a taxpayer for incremental tax caused by the preparer's mistake, which indemnification was ruled excludable) to all tax insurance premiums.³⁰⁵ But a statutory fix for these issues is preferable. Under § 265, expenses and interest incurred to obtain tax-exempt income generally are not deductible.³⁰⁶ (Were § 265 not the law, then taxpayers could, for example, borrow money to purchase municipal bonds, and

301. That is, if the insured recovers \$126.58 million, and all of it is treated as income, then after a 21 percent corporate tax, the insured receives exactly \$100 million.

302. Recall that, without the incremental gross-up cost, the taxpayer is paying \$5 million for \$100 million of coverage. The additional gross-up cost—\$1.595 million—is about 27 percent of \$5 million.

303. See *supra* note 294 and accompanying text.

304. 40 B.T.A. 333 (1939).

305. See *id.* at 334–35. For a brief overview of the facts in the *Clark* case, see *supra* note 140. The logic of extending *Clark* to the tax insurance context would be that the assumption of a tax liability by a third party purely due to risk in the filing position is not gross income to the indemnified taxpayer. Whether the IRS could, using only its administrative toolkit, finesse a distinction between this rule and the rule from *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716, 719–20 (1929), according to which an employer paying the income taxes of an employee has paid additional compensation to the employee, leaves considerable doubt.

306. See I.R.C. § 265(a)(1) (providing that deduction is allowed for “[a]ny amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest . . . wholly exempt from the taxes imposed by this subtitle”). Kahn argues that § 265 should not apply to premiums anyway, because that provision does not apply to “expenses that produce an item which simply is not income as distinguished from an item of income which is excluded from taxable income.” Kahn, *supra* note 23, at 24 & n.98.

thus recoup a double tax benefit: an interest deduction and tax-free income.)³⁰⁷ A policy of deducting tax insurance premiums *and* excluding the proceeds of the policies could run afoul of § 265, meaning the deductions would be disallowed. True, § 265 would not seem to apply if the recovery of proceeds constitute, as Kahn suggests, *non-income* rather than *income that is excludable*.³⁰⁸ But given the possibility that it would apply, a statutory fix providing for deductibility of premiums, exclusion of proceeds, and an exception to § 265 would seem appropriate.

This proposed tax benefit for tax insurance might seem unusual. It allows a double tax benefit for the taxpayer—deducting expenses for a financial product whose return is effectively tax-free—and that is exactly what § 265 is designed to stop. But the treatment is justified not only to protect tax insurance, but also when one remembers its economic equivalence to pre-enforcement challenges. A successful pre-enforcement challenge to a tax law (were it not barred by the AIA) also yields a double tax benefit.³⁰⁹ Thus, if we are following the economic substance, tax insurance should receive the same tax treatment as a pre-enforcement challenge—that is, the double benefit. Recall that a successful pre-enforcement challenge by a taxpayer would generally have two economic features: (1) costs, mainly litigation expenses and (2) a judgment enjoining the government from assessing or collecting tax or declaring that the asserted tax is not in fact due and payable. Each of these would carry a tax benefit (deductibility and excludability, respectively).

First, generally speaking, if the taxpayer carries on a business,³¹⁰ then the litigation expenses would be deductible as an ordinary and

307. See I.R.C. § 163(a) (interest deduction); *id.* § 103(a) (exclusion for interest on state and local bonds).

308. See Kahn, *supra* note 23, at 24 n.98 (“[T]he provision has not been applied to general liability insurance premiums, probably because those proceeds are not an item that is excluded or deferred from income by any tax provision (unlike proceeds from life insurance, which are exempted from income by Code § 101) but rather are simply not treated as income at all. The same reasoning should apply to tax insurance premiums, and thus Code § 265 should not bar a deduction for such premiums.”).

309. Indeed, the fact that there is a double tax benefit here suggests that Kahn is correct that recovery of insurance proceeds is non-income rather than income that is excludable.

310. Legal expenses probably would not be deductible by an individual. Section 212(3) provides individuals a deduction for “ordinary and necessary expenses” paid “in connection with the determination, collection, or refund of any tax,” which would seem to apply cleanly to a pre-enforcement challenge. I.R.C. § 212(3). But the § 212 deduction is a “miscellaneous itemized deduction,” *id.* § 67(b), and since the Tax Cuts and Jobs Act of 2017, miscellaneous itemized deductions have been disallowed, *see id.* § 67(h). Consequently, deducting litigation expenses with respect to a pre-enforcement challenge would be limited to business entities or individuals engaged in a business (and if the challenged tax issue relates to that business). In light of this treatment under current law, Congress would probably want to limit the deduction for tax insurance premiums to

necessary business expense. Whether legal fees (and associate expenses) are deductible (or, alternatively, personal or capitalizable) generally looks at the “origin and character of the claim”—that is, what the lawsuit aims to achieve.³¹¹ In the particular case of a suit to stop the IRS from collecting tax, what the taxpayer is trying to achieve is a determination that it does not owe a debt to the government. But legal expenses incurred to resolve a debt claim are deductible.³¹² Although there is a long line of cases explaining that legal fees to protect a capital asset are not deductible (but rather capitalizable into the asset),³¹³ in a pre-enforcement challenge, a taxpayer is seeking to protect cash, which is generally not a capital asset.³¹⁴

Second, even if the receipt by a plaintiff of an injunction or declaration could in principle be a taxable event, there could not possibly be income in the case of a pre-enforcement challenge to taxation. That is because the non-payment of taxes is not an accrual of economic value to the taxpayer.³¹⁵ If it were otherwise, then every audit or tax contest that resulted in no additional tax collected would, *ipso facto*, mark a taxable event to the taxpayer and the accrual of income to the taxpayer.³¹⁶ That

businesses. That accords with the current state of the tax insurance market, in which most insured issues are business in nature, but may become inappropriate if more and more individuals seek to purchase tax insurance with respect to non-business issues.

311. See *United States v. Gilmore*, 372 U.S. 39, 49 (1963) (“[T]he origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense was ‘business’ or ‘personal’ and hence whether it is deductible or not . . .”).

312. See, e.g., *Rushing v. Comm’r*, 58 T.C. 996, 1002 (1972) (expenses to settle a claim for personal guarantee were deductible, notwithstanding the fact that the guarantee was related to a stock purchase); *Tarakci v. Comm’r*, 80 T.C.M. (CCH) 727, 733 (2000).

313. See, e.g., *United States v. Hilton Hotels Corp.*, 397 U.S. 580, 583–84 (1970) (legal expenses in a stock appraisal action were not deductible).

314. Surprisingly, there are very few authorities on this point; however, the Court has narrowly construed the term “property” in the relevant Code section defining “capital asset.” See *Comm’r v. Gillette Motor Transp., Inc.*, 364 U.S. 130, 134 (1960) (“‘[C]apital asset’ is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time . . .”). Because cash does not appreciate, it is not a capital asset.

315. See *Comm’r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955) (describing income as “accessions to wealth, clearly realized, and over which the taxpayers have complete dominion”).

316. The Court has explained that the economic benefit that accrues to a taxpayer because of a sustained deduction or credit is not taxable income. *Randall v. Loftsgaarden*, 478 U.S. 647, 657 (1986) (“Unlike payments in cash or property received by virtue of ownership of a security—such as distributions or dividends on stock, interest on bonds, or a limited partner’s distributive share of the partnership’s capital gains or profits—the ‘receipt’ of tax deductions or credits is not itself a taxable event, for the investor has received no money or other ‘income’ within the meaning of the Internal

accrual would itself generate a tax liability.³¹⁷ But that cannot be right. Such a conclusion would mean that a taxpayer's success in a dispute with the IRS—even at the administrative level—results in an incremental tax. In other words, the taxpayer loses even when she wins.³¹⁸ And the same analysis would apply to a taxpayer that successfully secures a PLR from the IRS. Reasoning from these examples, the receipt by a taxpayer of an injunction or declaration in a pre-enforcement challenge that the taxpayer owes no additional tax could not possibly be an accrual of income to the taxpayer, meaning it is effectively excludable.

The tax treatment described here would be advantageous to taxpayers and insurers alike, helping drive down costs and promote an industry that has proven itself useful to both taxpayers and the IRS. But policymakers can also condition this favorable treatment on the taxpayer purchasing the kind of mainstream, unproblematic insurance that has grown over the last several decades. In particular, favorable tax treatment should be conditioned on the insured tax position not being a tax shelter or reportable transaction. In addition, favorable treatment should be conditioned on the policy being one that insures a transaction, an issue, or a cluster of interrelated transactions or issues, meaning general tax liability insurance policies would be subject to comparatively harsher tax treatment and thus are more costly.³¹⁹ Unlike mandating tax insurance or regulating which positions should get preferential insurance terms, clarifying tax insurance's tax treatment could stabilize and support tax insurance for decades to come.

CONCLUSION

Tax insurance will be part of the future of tax law and tax practice; the question before policymakers is what role it will play. Until now,

Revenue Code.”). But if the application of a deduction to taxable income or a credit to tax liability ultimately reduces tax owed by the taxpayer and nevertheless represents no economic benefit to the taxpayer, then for the same reason, the failure to assert additional tax by the IRS or a determination by a court that no additional tax is owed would also not result in a taxable event.

317. See I.R.C. § 61(a) (including in gross income “all income from whatever source derived”).

318. Were the opposite true—success in an audit itself causes the realization of income—consider a rather absurd example. Say the IRS audits a corporation, arguing that it failed to include \$10 million in income, meaning the IRS asserts an additional \$2.1 million in tax. If the IRS loses, then the taxpayer would be deemed to have had \$2.1 million in income. On that deemed income, the taxpayer would owe \$441,000 in tax (21% $\times$ \$2.1 million). Thus, although the IRS would not have collected as much tax as it would have liked, it still would collect something, even though the taxpayer was substantively correct in the first instance.

319. These conditions would almost certainly require action by Congress, rather than mere administrative action by the IRS, given that these conditions are connected nowhere to the taxation of insurance under current law.

commentators have rightly noted that tax insurance provides a market-based response to tax law uncertainty, but they have not acknowledged that that uncertainty arises from a structural asymmetry built into the American tax system: the AIA. As this Article has demonstrated, the AIA's procedural bar leaves taxpayers stranded with ex ante tax risk—uncertainty about the tax consequences of their conduct before they engage in it—without a public-law mechanism to resolve it. Tax insurance steps into that void, providing a private, market-based product that mimics a pre-enforcement challenge from the perspective of a taxpayer.

Far from needing new restrictions, the tax insurance market deserves careful support. Policymakers should avoid distorting the industry through overregulation or conscripting it into the Service's compliance machinery. Instead, policymakers should take modest, targeted steps—in particular, clarifying the treatment of tax insurance itself—to support tax insurance. Such a reform would not only align tax insurance with its economic analog in administrative law, but it would help restore parity between taxpayers and other regulated entities. In the end, we can return to a world where, as the old saying goes, there really are only two things certain in life: death and taxes.³²⁰

320. See *supra* note 1.

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