



Brucker & Morra

# on Benefits

How pension and welfare benefits laws affect your clients today

## Beware of Unjust IRS Penalties

You should be aware that your clients, through no fault of their own, may be facing severe financial hardship if, since 2004, they invested in any of these three types of plans:

- **Welfare Benefit Plans (Section 419 Plans) funded with accumulating cash value life insurance policies.**
- **Defined Benefit Pension Plans that invest in accumulating cash value life insurance policies with face amounts exceeding the Plan's "incidental death benefit limitation" by \$100,000.**
- **ROTH - IRA transactions where the client's business income shifted to a Roth-IRA to avoid income tax.**

These investments are considered "listed transactions" and are deemed abusive tax shelters by the Internal Revenue Service. Such tax shelters must be reported to the IRS on Form 8886. IRC Section 6707A imposes fines of \$100,000 per individual and \$200,000 per entity each year for failure to file Form 8886, Reportable Transaction Disclosure Statement.

The penalties are being imposed without regard to culpability. The fines are mandatory, even if the investors had no knowledge that they were entering into listed transactions or had no intention to make potentially disputed investments. The IRS can impose the penalty even if taxpayers owe little or no tax on the transaction.

*I urge you to immediately contact your clients who may be subject to these unjust penalties.*

*In our opinion and the opinion of the National Taxpayer Advocate, fines permitted by 6707A constitute an "unconscionable hardship on taxpayers."*

This law is an assault on common sense. It was written to halt multi-million-dollar abuses by major investors. Instead, it has entrapped unwitting individual taxpayers and owners of small businesses. That's because the current law does not require the sellers of these questionable investments to alert their clients to the potential jeopardy. What's more, neither the IRS nor the courts can abate the penalties, even if reasonable cause exists. This situation belies the underlying fairness of our tax system, which is essential for a system that largely relies upon voluntary compliance.

*I need your help to change this draconian law.*

As a director of the Small Business Council of America ([www.sbca.net](http://www.sbca.net)), I am working with U.S. Sen. Ben Nelson (D-Nebraska) and U.S. Rep. Joe Donnelly who are submitting bills urging Congress to substantially reduce the harshness of the penalty and to grant taxpayers constitutional rights to due process. We are also working with Sen. Nelson and Rep. Donnelly to place an immediate moratorium on the assessment and collection of the IRC Section 6707A penalty. Please see below for more about the Small Business Council of America.

Sen. Nelson introduced Senate Bill 765 to curb abusive tax shelters and eliminate the disproportionate and probable unconstitutional impact on small businesses and their owners. We expect Congressman Donnelly to introduce his bill this week. My SBCA colleagues and I have added protective provisions for small businesses, and we anticipate they will be in the final version when enacted.

*If your clients are being penalized by 6707A, I would like to hear from you about the severe effects of these penalties on their lives and livelihoods. Please contact me by email [Please contact me by email at abrucker@pensionlawyers.com](mailto:abrucker@pensionlawyers.com) or call me directly at 310.954.2178.*

*Your clients' unfortunate experiences will bring this matter to the attention of other members of Congress and strengthen our case for changing the current law.*

### *Take a Look at What Can Happen*

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Here are some shameful examples of how Section 6707A affects taxpayers:

- A Midwest dentist thought he had settled his welfare benefit plan issues with the IRS when he paid his tax through the Global Settlement Initiative in 2005. After the closing, the IRS informed him that he owed an additional penalty of \$300,000 for failing to file Form 8886. The Settlement Initiative failed to include or even alert him to 6707A penalties.
- The owner of a small asphalt-paving company in Indiana bought a "springing cash value" life-insurance policy inside an employee 412(i) plan as an alternative to a straightforward pension plan. In 2004, two years later, the IRS listed this type of plan as an abusive tax shelter. The financial advisor who sold the plan neglected to alert his client to the determination. When the owner inadvertently failed to file Form 8886, the IRS demanded taxes and interest totaling \$60,000 on the investment and \$600,000 in penalties.
- A husband and wife in Hawaii owned and operated a small business. On advice from their highly credentialed tax consultant, they established a

limited liability company with Roth IRAs. The IRS audited the LLC in 2008 and determined that their Roth IRA was "substantially similar" to listed transactions. The IRS dismissed the taxpayers' claim that the transactions were not similar to the actual listed transaction. The agency also determined that the taxpayers had no right to challenge its determination in court. The couple had to pay \$6,812 in assessed income tax deficiencies. Additionally, the IRS demanded Section 6707A penalties of \$1.2 million. The couple is considering bankruptcy.

I will bring you more news about this situation as events unfold. I encourage you to forward this newsletter to others who may benefit from the information.

When you call me (310.954.2178) or email me at [abrucker@pensionlawyers.com](mailto:abrucker@pensionlawyers.com) so I can advise you and your clients about the best way to deal with their own 6707A cases.

Sincerely,

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Brucker & Morra is Southern California's largest firm exclusively practicing employee benefits law. We have expertise in every tax and labor aspect of ERISA.

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The Small Business Council of America is your advocate.

The SBCA is the only national organization whose sole purpose is to represent the interests of privately and family owned businesses in federal income and estate tax, health care, pension and other employee benefit areas.

The primary goal of the SBCA is to enact favorable federal tax and employee benefit laws for small businesses and their owners. The SBCA supports legislation that creates important economic incentives, and opposes oppressive and burdensome laws and proposals.

For more information, visit the SBCA on the web at <http://www.sbca.net>

For membership information, click on this link: <http://www.sbca.net/memberbenefits.html>