

BRUCKER



MORRA

A Professional Corporation

on Benefits

Exclusively practicing employee benefits law ♦ ERISA ♦ and benefits taxation

Small Business Council of America Offers Ideas to Congress To Correct IRC 6707A Penalties And Protect America's Small Businesses

By Alex M. Brucker
October, 2009

The SBCA is hailing the initiative of key Congressmen who, in July, successfully encouraged the IRS Commissioner to halt collections from small businesses owners who were hit by 6707A penalties for failing to report so-called listed transactions in their retirement and welfare benefit plans.

IRS Commissioner Douglas Shulman originally suspended collection efforts of listed transaction disclosure penalties until September 30, 2009.

In a recent letter to ranking members of the Senate Finance and the House Ways and Means Committees, Commissioner Shulman announced that he extended the moratorium until December 31, 2009. The suspension affects situations in which the annual tax benefits received from a listed transaction are less than \$100,000 for an individual or \$200,000 for others.

The SBCA is continuing its efforts for permanent changes in the tax code. Under my leadership, the small business advocacy organization offered suggestions in a formal position paper to Congressional Finance Committee members who will be crafting new tax law.

This issue of "Brucker & Morra On Benefits" summarizes those recommendations.

Many of you in financial and investment fields told me you have been able to use the information in this newsletter to advise your clients about making invest-

ments in their retirement or benefits plans. Our goal is to give you the latest information on serving your clients' best interests.

The Small Business Council of America (<http://www.sbca.net>) is encouraging Congress to change the tax law that will save small business owners from onerous penalties originally meant to stop major corporations from evading taxes in tax-abusive investments.

This Spring, armed with information from the SBCA, key Congressmen asked the IRS to stand down on collecting millions of dollars from small business owners who inadvertently invested in "listed transactions." The IRS agreed.

The current SBCA effort, led by Alex Brucker, encourages Congress to make permanent changes to the Internal Revenue Code so penalties will be fair to small companies. The SBCA emphasizes that any new law must still maintain vigilance over illegal investments.

The listed transactions that have proved troublesome to small businesses and their owners, reports the SBCA, include the following retirement and health and welfare plans:

- Certain arrangements claiming to qualify as multiple employer welfare benefit funds under Internal Revenue Code §419A(f)(6)
- Certain transactions designed to avoid the limitations on contributions

Attorneys

- Alex M. Brucker
- Linda Russano Morra
- Michael L. Cotter
- Meredith J. Sesser
- Cathryn B. Sportsman
- Jeremy M. Pelphey

T: (310) 475-7540

F: (310) 470-4806

W: www.pensionlawyers.com

to Roth IRAs.

- Certain insured defined benefit retirement plans holding excessive cash-value life insurance.
- Certain single employer employee welfare benefit funds, described in IRC §419, funded with cash value life insurance.

Taxpayers are responsible for reporting to the IRS that they participated in transactions that the IRS had determined - and noted on its website - to be abusive "listed transactions." The penalties imposed by Section 6707A of the tax code are actually for failure to self-report these types of investments. Although the law was written and toughened in 2004, taxpayers began receiving notices this year, after IRS examinations of their returns, to pay a minimum of \$100,000 per person per year in the case of individual investors and \$200,000 per year for business entities. Penalties often exceed \$1 million on mere thousands of dollars due in taxes.

The key issue, notes the SBCA, is that the 6707A penalty applies regardless of the amount of understatement of tax, even if the taxpayer owes no additional taxes. In other words, a taxpayer is subject to the 6707A penalty for failure to disclose participation in a listed transaction even though the transaction is found to be compliant with the tax law.

SBCA tax specialists pointed out that Congress had the best of intentions to catch and punish law-breakers. Under the law of unintended consequences, however, Congress presented the IRS with an enforcement directive that essentially forced thousands of America's small businesses and their owners to declare bankruptcy.

To remedy this situation, the SBCA published an extensive Position Paper urging Congress to enact relief legislation.

Highlights:

- Provide an equitable penalty that is

based on (and proportional to) the understatement of tax resulting from the listed transaction.

- Limit the 6707A penalty to 20 percent of the tax understatement.

A 20-percent penalty of the tax understatement, when added to an existing 30-percent accuracy-related penalty, would equal a combined penalty of 50 percent of the tax understatement attributable to a listed transaction.

- Impose a proportional ceiling on the 6707A penalty.

The intent of Congress is to not to shut down American business due to the imposition of the penalty. Accordingly, the ceiling on small business should be limited to \$25,000.

- Establish a de minimis \$15,000 tax understatement before the 6707A penalty would apply.

The SBCA notes that the 6707A penalty was intended to punish major corporate taxpayers who engaged in multi-million-dollar tax-motivated transactions that lacked economic substance and business purpose. A pension or welfare plan established by a small business to produce a de minimis tax understatement (not in excess of \$15,000) is not the type of listed transaction that Congress intended to punish.

- Limit the 6707A penalty to \$10,000 for pass-through entities (S Corp, Partnerships, LLCs, etc.).

If pass-through entities must be responsible for filing the IRS disclosure form 8886, but do not obtain any tax benefit from a listed transaction, the 6707A penalty imposed on pass-through entities should be limited to \$10,000. Additionally, the amended proportional penalty should apply at the individual shareholder, partner or member level.

- Grant the taxpayer the right of judicial review.

DISCLAIMER

The information contained herein is provided by Brucker & Morra, APC as general information to clients and friends. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered ATTORNEY ADVERTISING in some states.

The right of judicial review should be granted to taxpayers to seek impartial review in Tax Court as to whether or not a transaction is a listed transaction or one that is "substantially similar" to a listed transaction. The right of judicial review is necessary to provide a check and balance on the broad discretion of the IRS to determine what is a listed transaction, and more importantly, what makes the substantially similar transaction a listed transaction.

- Require listed transactions to be subject to publications like a Treasury Regulation with adequate notice and an opportunity for public comment.
- Allow amended returns.

Taxpayers who want to comply with the required disclosures and avoid the 6707A penalty for failure to make a timely filing the Form 8886, should be allowed to comply by filing an amended tax return so long as the amended return is filed before the earlier of (1) the date the taxpayer receives notice of an examination of its tax return; or (2) the date a "John Doe" summons is issued to the material advisor or a promoter; and

- Grant the Commissioner of the Internal Revenue Service the discretion to abate the penalty under special circumstances.

To view the entire text of SBCA recommendations, click here: <http://www.pensionlawyers.com/docs/SBCAArticle.pdf>

DISCLAIMER

The information contained herein is provided by Brucker & Morra, APC as general information to clients and friends. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered ATTORNEY ADVERTISING in some states.