Part 1 – IRS "Listed Transactions"

You should expect tax audits for 2006 and 2007 to be up greatly as the IRS spends its 50% audit budget increase. Legal strategies to "protect assets" or common schemes to avoid or even "reduce" taxes may face new challenges as the IRS places more and more common strategies on the naughty list. You must realize that yesterday's commonly accepted "legal" strategies to protect assets or reduce taxes many now be viewed as illegal or impotent.

As you know, every year the IRS maintains and amends a list of what it deems to be tax scams (also called "listed transactions"). It was first termed the **IRS "DIRTY DOZEN."** This warning is now some 31 items and growing! Taxpayers are required to file Federal Form 8886 and voluntarily disclose involvement with any "listed transaction." Involvement with tax scams can result in possible "imprisonment and fines" for the client and the professional advisor. Moreover, the IRS will obtain a list of all of your clients and aggressively review them as well. In addition to enforcing taxpayers or tax promoter violations of the "listed transactions," the IRS is launching a $100 million research project to audit more small businesses, especially sub-chapter "S" corporations and ESOP abuses. The IRS will also highly scrutinize business owners who have implemented "employee leasing" scams, abusive employee benefit and medical plans, life insurance, annuity, pension and pre-tax employment scams, abusive indirect ROTH IRA contribution transactions, among others. Some of the listed scams and suspect transactions are:

"Trust Misuse"

Hands off Certain Trusts!

The IRS is actively examining professionals who, and transactions that" …promise reduction of income subject to tax, deductions for personal expenses and reduced estate or gift taxes."

“Offshore Transactions” & U.S. Citizens

Hands off “Offshore!”

“Experts estimate that Americans now have more than $1 trillion in assets offshore and illegally evade between $40 and $70 billion in U.S. taxes each year through the use of offshore tax schemes.” {emphasis added} [Tax Haven Abuses, The Enablers, The Tools and Secrecy, August 1, 2006, U.S. Senate Committee on Homeland Security and Governmental Affairs, Norm Coleman, Chairman, Carl Levin, Ranking Minority Member]

“Individuals continue to try to avoid U.S. taxes by illegally hiding income in offshore bank and brokerage accounts or suing offshore credit cards, wire transfers, foreign trusts, employee leasing schemes, private annuities or life insurance to do so. The IRS…..continues to **aggressively pursue taxpayers and promoters** involved in such abusive transactions.” {emphasis added}

Prohibited “Employment Tax Evasion” Programs

Hands off “Employee Leasing Tax Schemes”

Promoters (i.e. accountants, CPAs, CFPs, lawyers, marketers, banks, brokers, etc.) of **employee leasing tax shelters** which would have a client resign his/her position, open a foreign leasing company holding such employment rights, and open deferred pension plan/trust, all designed to avoid or defer compensation and employment or income taxes, should expect an IRS or Justice (criminal) examination.

Also, have your client employers resist employees who demand that the employer not withhold employment or income taxes from wages. You and your client (employer) may be liable for back taxes, penalties and interest.

Avoiding or Deferring Tax on Sale of Assets

Hands off Private Annuity Trusts!

Promoters of the Private Annuity (Trust) used to transfer appreciated assets to a trust to avoid or defer taxable gains on a sale, are "suspect". The IRS may disregard the "form" of a structure if it finds a lack of "economic substance". Judges may also find intent to defraud creditors. Although there are legitimate purposes and used for such annuities or trusts, the IRS will conduct hearings in 2007 prior to issuing new rules governing same. We will update you on those hearings and new rules in Part 2 of this article.

Prohibited Life Insurance (Swiss Annuity) Arrangements

Hands Off PPLI!

Offshore Private Placement Life Insurance (PPLI) and Swiss Annuity are on the IRS abusive field advice list. A PPLI involves the use of variable universal life insurance (or Swiss Annuity or variable annuity product), a dummy offshore insurance company which returns premiums back to the PPLI policy, and/or the selling of business interests to avoid taxes.

Prohibited Deferred Compensation Plans

Hands Off Deferred Compensation!

Use of pension plans and offshore devices to defer compensation and avoid taxes is prohibited.

Multinational Corporations

Hands Off Offshore Tax Evasion

Multinational companies must especially review and/or legally reverse offshore transactions that are suspect or considered acts or illegal tax evasion, including certain intra-company "transfer pricing", offshore holding structures and Enron-type special purpose entities or trusts (i.e. SPEs, IVEs). "A 2004 report found that U.S. multinational corporations are increasingly attributing their profits to offshore jurisdictions, allocating $150 billion in 2002 profits to 18 offshore jurisdictions, for example, up from $88 billion just three years earlier." [Tax Haven Abuses, The Enablers, The Tools and Secrecy, August 1, 2006, U.S. Senate Committee on Homeland Security and Governmental Affairs, Norm Coleman, Chairman, Carl Levin, Ranking Minority Member]

Business Entities vs. Personal Entities

Hands Off The Personal Use FLP/LLC!

Even the commonly used family limited partnership ("FLP") or Limited Liability Company ("LLC") may be under attack. A "business" entity used for "personal" purposes may cause the entity to be held invalid altogether. The line of what a FLP/LLC can be used for is becoming troublesome. Such recharacterization may cause you and your client great expense, taxes, penalties, loss of assts, and personal liability. **Remember, trusts are for personal uses, business entities are for business uses.**

What to Do?

If you or your clients are in any such deals, hire counsel, take action to voluntary disclose such involvement, undo the transaction, pay any and all taxes (etc.), and show that you or your client did not have an ill-intent. You may call for more information or update on these topics at 949-798-6206.