

# IRS Goes After Captive Insurance

by Lance Wallach

Life insurance agents recently started pushing the newest variety of high-ticket items. After the IRS almost put 419 plans out of business and severely curtailed abusive 412i plans they needed another way to sell large commission life insurance policies. Many of the promoters of the 419 and 412i plans are now promoting section 79 and captive insurance plans. They claim that these plans allow businesses to tax deduct life insurance. As in the past, these promoters claim that most of the benefits would be for the business owners. I have been an expert witness in many cases against these abusive plans and my side has never lost a case.

Recently, my office has been receiving over 50 calls per month from people that are being threatened with large IRS fines. Most of these people (including CPAs) do not understand why this is happening. These fines are primarily the result of greed from insurance companies, insurance agents, plan promoters and even the IRS. Insurance companies are always looking for ways to sell large amounts of life insurance. Taxpayers are constantly looking for larger tax deductions. Insurance agents want to earn large life insurance commissions. The IRS has started additional enforcement action against taxpayers and accountants.

Taxpayers must report certain transactions to the IRS under Section 6707A of the tax code, to help detect, deter, and shut down abusive tax shelter activities. For example, reportable transactions may include participants in 419, 412i, or other insurance plans sold by insurance agents for tax deduction purposes. Other abusive, listed, or reportable transactions could include captive insurance and Section 79 plans, which are usually sold by insurance agents for tax deductions. Taxpayers must disclose their participation in these and other transactions by filing a Reportable Transactions Disclosure Statement (Form 8886) with their income tax returns.

People that who these plans are

called "material advisors" and must file form 8918 properly. Failure to report the transactions could result in huge potentially heinous monetary penalties. Accountants who sign tax returns that claim these deductions can also be called material advisors and should also file form 8918 properly.

Not all 412i, captive insurance and Section 79 plans are abusive, listed or reportable transactions, but almost all the Section 79 and captive insurance plans that I have recently seen are abusive. Recently I have had discussions with IRS personnel on point. But even as far back as 2002, I spoke at the annual national convention of the American Society of Pension Actuaries on potential abuses. I also was asked by the then acting IRS commissioner to meet with high level IRS executives to further discuss these issues. At this meeting with senior IRS officials, there was a speakerphone so that high-level Treasury officials could listen in on the conversation. Within a year of this meeting, the IRS escalated its attack on participants in 419 Welfare Benefit Plans.

The IRS has fined hundreds of taxpayers who did file under 6707A. They said that they did not fill out the forms properly, or did not file correctly. The plan administrator or a 412i advised over 200 of his clients how to file. They were then all fined by the IRS for filling out the forms wrong. The fines averaged about \$200,000 per taxpayer.

A report by the Treasury Inspector General for Tax Administration (TIGTA) found that the procedures for documenting and assessing the Section 6707A penalty were not sufficient or formalized, and cases often are not fully developed.

TIGTA evaluated the IRS's effectiveness in identifying, developing, and applying the Section 6707A penalty. Based on its review of 114 assessed Section 6707A penalties, TIGTA determined that many of these files were incomplete or did not contain sufficient audit evidence. TIGTA also found a need for better coordination between the IRS's Office of Tax Shelter Analysis and other functions.

The Section 6707A penalty is a stand-alone penalty and does not require an associated income tax examination; therefore, it applies regardless of whether the reportable transaction results in an understatement of tax. TIGTA determined that, in most cases, the Section 6707A penalty was substantially higher than additional tax assessments taxpayers received from the audit of underlying tax returns. I have had phone calls from taxpayers that contributed less than \$100,000 to a listed or reportable transaction and were fined over \$500,000. I have had phone calls from taxpayers that went into 419 or 412i plans, made no contributions, but nevertheless were fined a large amount of money for being in a listed transaction and not properly filing forms under IRC section 6707A. The IRS claims that the fines are non-appealable.

If you are, or were in a 412i, 419, captive insurance or section 79 plan you should immediately file under 6707A protectively. If you have already filed you should find someone who knows what he is doing to review the forms. I only know of two people who know how to properly file. The IRS instructions are vague and are useless if you are filing late since they presume a timely file. If a taxpayer files wrong, or fills out the forms wrong he still gets the fine. I have had hundreds of phone calls from people in that situation. □

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