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TOPIC: Life Insurance, Welfare Benefit Plans and Listed Transactions

CITATIONS: *Vee's Marketing, Inc. v. United States*, No. 13–cv–481–bbc, WL 5106716 (U. S. D. C., W.D. WI Oct. 10, 2014); IR Notice 2000-15; Form 8886; IR Notice 95-34; IRC 6707A.

SUMMARY: The plaintiff corporation participated in a welfare benefit plan that was purportedly structured to fall within IRC Section 419A(f)(6). Under that Code Section, if 10 or more employers participated in the welfare benefit plan, the employer contribution was arguably entirely tax deductible.

The IRS had previously ruled that the use of the 10 or more employer exemption to try and provide for a permanent cash value policy was a "listed transaction" (essentially a "prohibited tax shelter") which required it to be reported on Form 8886. The plaintiff did not file the form, was subsequently fined $40,000, and sued to recover the fine.

The U.S. District Court summarily dismissed the case and left the fine intact.

BACKGROUND: Plaintiff, Vee's Marketing, Inc., sued defendant United States of America for a refund of $40,000 in penalties the IRS assessed and collected from it for failing to file a Form 8886 with respect to deductions it claimed for contributions it made to a welfare benefit plan for the years 2004 to 2007. Any taxpayer, including an individual, trust, estate, partnership, S corporation, or other corporation, that participates in a "reportable transaction" and is that is further required to file a federal tax return or information return must, in addition, file Form 8886. A "reportable transaction" includes "listed transactions." A listed transaction is "a transaction that is similar or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction."

These transactions are subsequently described and published by the IRS in regulations, notices and rulings. The instructions to Form 8886 note that:

> You have participated in a listed transaction if any of the following apply:
>
> - Your tax return reflects tax consequences or a tax strategy

described in published guidance that lists the transaction.

- You know or have reason to know that tax benefits reflected on your tax return are derived directly or indirectly from such tax consequences or tax strategy.

- You are in a type or class of individuals or entities that published guidance treats as participants in a listed transaction.

In general, the term "listed transaction" is synonymous with the term "prohibited tax shelter." Under Code Section 6707A, the penalty for failure to include reportable transaction information with a tax return has a maximum penalty of: (1) in the case of a listed transaction, $200,000 ($100,000 if a natural person), or (2) in the case of any other reportable transaction, $50,000 ($10,000 if a natural person). The *minimum* penalty is set at $10,000 ($5,000 if a natural person).

In IR Notice 2000-15, 2001-1 CB 826, the IRS stated that listed transactions included those described in Notice 95-34, 1995-1 C.B. 309 (certain trust arrangements purported to qualify as multiple employer welfare benefit funds exempt from the limits of §§ 419 and 419A of the Internal Revenue Code).

In turn, IR Notice 95-34 was written to alert taxpayers and their representatives to some of the significant tax problems that may be raised by 10 or more employer arrangements. This Notice stated that:

> In recent years a number of promoters have offered trust arrangements that they claim satisfy the requirements for the 10-or-more-employer plan exemption and that are used to provide benefits such as life insurance, disability, and severance pay benefits. Promoters of these arrangements claim that all employer contributions are tax-deductible when paid, relying on the 10-or-more-employer exemption from the section 419 limits and on the fact that they have enrolled at least 10 employers in their multiple employer trusts.

The use of this exemption allegedly allowed for the funding of permanent life insurance benefits rather than the "term only" rules of Code Sections 419 and 419A.

In the current case, Vee's Marketing participated in a plan which supposedly qualified as a 10 or more employer plan, and which provided for permanent life insurance. They were fined for failing to report this on Form 8886, paid the fine, and then instituted suit for a refund in the U.S. District Court.

FACTS: The plaintiff made four arguments:

First, it alleged that Notice 95-34 did not necessitate the filing of Form 8886 since it did not use the terms "tax strategy" or "tax consequences" and further arguing that neither the notice nor the applicable regulations define those terms.

Second, it argued that because "tax strategy" and "tax consequences" are used *separately* in the same regulation, the two phrases must have distinct and therefore different meanings.

Third, the plaintiff argued that the IRS did not disclose its argument regarding its understanding of the terms “tax strategy” and “tax consequences” during discovery and,

Fourth, their “tax strategy” includes conduct that is legal; and that therefore, tax penalties should be construed in favor of the taxpayer.

The court disagreed. It held

> …that the terms “tax strategy” and “tax consequences” are easily understood according to their ordinary meaning and that, under that ordinary meaning, Notice 95–34 describes a tax strategy and tax consequences, plaintiff cannot support its position by citing canons of statutory construction for interpreting ambiguous terms.

RESULT: The U.S. District Court held that the $40,000 fine was valid and denied the refund.

RELEVANCE: This case emphasizes the real life consequences of a welfare benefit plan funded in part with permanent, cash value life insurance policies. Many previous *Washington Reports* have reported of a failure on the part of participants or promoters to successfully argue that these plans are valid in a legal sense. Indeed, every single one of these numerous cases has been lost by the taxpayer. This case demonstrates the real life sting of a Section 6067A fine with regard to these plans—adding a failure to report insult to the tax penalty injury.

WRNewswire 14.10.22 was written by Tom Commito of Lincoln Financial Distributors.

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