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TOPIC: Penalties Imposed on 419 Plan Promoter

CITATION: *Koresko v. U.S.A*, No. 13-4131, 2015 WL 4976837 (U.S.D.C., E.D. PA, 8/15/2015).

SUMMARY: John Koresko, creator and promoter of an aggressive Section 419 VEBA plan, has been held personally liable for penalties imposed under Code Section 6700 for making statements in connection with promoting an abusive tax shelter regarding applicable tax laws that he should have known to be false based on published guidance and litigation, even prior to the issuance of final regulations.

RELEVANCE: This case is a reminder to AALU members that the promotion of aggressive tax structures and tax-avoidance strategies in defiance of IRS guidance and litigation positions could subject them personally to penalties even if the advice is given *prior* to the issuance of final Treasury regulations on the subject matter of the advice.

FACTS: Mr. Koresko, an attorney and certified public accountant specializing in estate planning, benefits and taxation, formed the Regional Employers Assurance Leagues which sponsored a Voluntary Employees' Benefit Association (the "REAL VEBA"), which Koresko and his brother, a non-attorney, marketed to business owners. The REAL VEBA purported to allowed small business owners to purchase cash-value life insurance for themselves without treating that benefit as taxable income and to deduct the premium payments from the business's income as a business expense.

Currently, there are more than 100 cases pending in US Tax court regarding the tax treatment of the REAL VEBA. However, this case relates to Code Section 6700 penalties imposed directly on Koresko *personally* and Penn-Mont Services, the plan trustee which Koresko set up and controlled. The penalty was imposed on Koresko for false statements he made in promoting the REAL VEBA as an abusive tax shelter.

To recover Section 6700 penalties, it was necessary for the government to demonstrate that Koresko:

(1) organized or participated in the sale of the REAL VEBA;

(2) made statements about the allowability of deductions or tax credits, excludability of income, or securing of other tax benefits;

(3) knew or had reason to know the statements were false; and

(4) the statements pertained to a material matter.

Koresko marketed the REAL VEBA as a "ten or more employer" (TOME) plan under Code Section 419A(f)(6). Deductions for most VEBA contributions are typically limited to costs of *current* benefits for the current year or for *limited* prefunding of future benefits. However, the Internal Revenue Code carves out an exception for VEBAs operating as TOME plans. If ten or more employers join a single plan, Section 419A(f)(6) permits deductions to be taken in earlier tax years.

For years, the definition of a Section 419 TOME plan, also called a "419 plan" had been controversial. In 1995, the IRS issued Notice 95-34, which clarified the Service's position that plans similar to Koresko's did not meet the requirements of Section 419. In subsequent years the IRS successfully sued taxpayers regarding their 419 plans. Nonetheless, some taxpayers continued to take the position that their 419 plans were permitted under the Code.

In 2000, the IRS issued Notice 2000–15, 2000–1 C.B. 826 which designated 419 Plans as "listed transactions" or "tax avoidance transactions." The IRS issued proposed regulations in 2002 intended to clarify the current law. Final regulations were issued in July 2003.

Koresko's REAL VEBA as amended and restated in 2002 did not fall within the definition of TOME under IRS guidance or the final regulations. Koresko widely promoted the REAL VEBA and the government claims that he knew or should have known that statements he made about the tax implications and benefits of the REAL VEBA were false or fraudulent.

Koresko tried to argue that he could not have known the his statements regarding the accuracy of the purported REAL VEBA tax benefits were false, because he did not know that the final regulations would alter the validity of the REAL VEBA.

The court rejected this argument due to the prior IRS notices, the years of IRS litigation, and the proposed rules which made the law clear regarding the definition a TOME. In evaluating whether Koresko knew or should have known that the REAL VEBA did not comply with legal requirements, the court looked at:

(1) the extent of the promoter's reliance upon knowledgeable professionals;

(2) the promoter's level of sophistication and education; and

(3) the promoter's familiarity with tax matters.

Since Koresko was both an attorney and CPA as well as a self-proclaimed expert in tax and benefits law he did not consult outside professionals and drafted all of the VEBA documents himself. Based on these facts, the court found that imposition of penalties under Code Section 6700 on Koresko personally was appropriate.

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