PART I

Everything You Need to Know About Listed Transactions Connected with Benefit Plans

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LISTED TRANSACTIONS IN CONTEXT OF LOCALLY PROMOTED 412(i) PLANS AND 419A(f)(6) OR 419(e) PLANS

Setting the Stage

Local insurance agents and Pension/Benefit Consultants are promoting use of three types of benefit programs for which virtually no one in this room should allow their clients to enter into (assuming you have some control over it). And if you or your clients do enter into such a benefit program - you need to exercise extreme caution to protect both yourself and your client. The notorious three are:

1. IRC § 412(i) fully insured Defined Benefit Plan with excess life insurance death benefit coverage. This is, and has been, potentially a "listed transaction" (described later) since spring 2004. A 412(i) Plan is a "listed transaction" for a given tax year if the face value of the life insurance death benefit provided to a participant is more than $100,000 in excess of the maximum allowable death benefit for a Defined Benefit Pension Plan and a deduction is taken for a contribution to the Plan. Other problems include:

- Life insurance exceeding 50% of Plan assets (disqualifying feature) - these Plans must promptly provide annuity policy coverage.
- Benefits provided under annuity policy not equaling the benefits provided under the Plan document.
- Cash value benefits for owners - and term or "discriminatory" coverage for non-owners.
- Failure to cover sufficient personnel to pass coverage tests.
- Failure to implement annuity insurance benefit coverage during the Plan Year (the IRS position is the policy must be purchased during the applicable taxable year - no 81/2 month grace period to purchase policy even if the tax return is on extension (the full premium can be paid up until the return due date assuming the policy was in force as of the end of the tax year).

NOTE - This discussion will focus primarily on "listed transaction" issues.

2. IRC § 419A(f)(6) Welfare Plans - This is a type of "pooled" VEBA that is allegedly maintained by multiple employers. No one employer can contribute more than 10% of the total contributions. And the Plan will not qualify for any favorable tax deduction treatment if the Plan has "experience rated" arrangements under which each employer's contributions and benefits are individually determined either on the contribution end or the benefit end - or both. A purported 419A(f)(6) Program that maintains experience rating for employers has been a "listed transaction" since Notice 2002-15. Other problems include:

- Contributions in excess of amounts deemed actuarially necessary to provide the cost of the death benefit (under "term coverage principles").

- Severance or disability benefit features that are in effect, intended to operate as "non-qualified deferral compensation plans". Deferred Compensation is NOT a permissible 419A(f)(6) benefit. And the Plan almost certainly can be deemed to violate IRC § 409A (a topic of its own).

- The Insurance Policies are almost always horrible economically: No one would buy them outside the context of a claimed big tax deduction.

- Funds are held by a third party trustee - out of client's control. Think about the implications of that.

3. 419(e) Welfare Plan. This is a single employer VEBA. Heavily promoted by insurance agents in recent years/months, deductions to this type of Plan were specifically limited in the Tax Reform Act of 1984. The net import of these limits "killed" the single employer VEBA tax shelter market and led to the (largely abusive) 419A(f)(6) programs. IRC § 419(e)'s limits basically limit deductions to amounts the employer could otherwise deduct without the VEBA, with some minor exceptions. Post retirement medical and life insurance benefits cannot be funded to extent:

1. Life Insurance face value exceeds $50,000.
2. Benefits do not cover a nondiscriminatory classification (IRC § 505(b)).
3. Benefits for key-employees (owners - IRC 416(i)) must be allocated to a separate account and allocations to this account reduce the maximum per person allocation of $45,000 to a 401(k) or other Defined Contribution Plan.

The typical 419(e)Program marketed to businesses as tax shelters was designated a listed transaction on October 17, 2007 in Notice 2007-83 - for fiscal years ending on or after November 5, 2007.

What is a "listed transaction"?

IRC § 6707A imposes penalties upon any person who fails to include information with respect to a "listed transaction" which is required under IRC § 6011 to be included on the return. The net impact of 6011 and 6707 is that a "listed transaction" must be reported on Form 8886 to avert the penalty under IRC § 6707A(b)(2).

A "listed transaction" is defined in IRC § 6707A(c)(2) as "a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary (of the Treasury) as a tax avoidance transaction for purposes of Section 6011".

What is the Penalty?

The penalty is (per tax year) $100,000 for a natural person and $200,000 for any other case.

What triggers the Penalty?

Deducting any amount ($1?) on an applicable return with respect to a "listed transaction" without filing Form 8886.

How is the penalty calculated by IRS in the field?

(Note: - this is based on current audit experience - trust me).

Sole proprietor - $100,000 per year.

C corporation - $200,000 per year (possibly penalty on shareholders if IRS successfully alleges "constructive dividend").

LLC/General Partnership - $100,000 per partner (assume taxed as a partnership).

S corporation - $200,000 on corporation, $100,000 per shareholder.

Example - 3 shareholders - $200,000 on "S" corporation, $300,000 on shareholders - Grand total - $500,000 per year!

Can the Friendly IRS Agent Waive the Penalty?

Not on paper. See IRC § 6707A(d)(1). Congress barred the IRS from this discretion.

Can you appeal imposition of the penalty to US Tax Court or Federal District Court?

No. See IRC § 6707A(d)(2).

Can You Amend a Return to Add Form 8886 - and thus Avert the Listed Transaction Penalty? (this took some research and discussions with the IRS to dig out - the accounting profession is, per discussions with many, including Big Four, unaware of this).

Generally NO! See Reg 1. 6604 - 2(3)(ii).

The net import of this Reg (issued January 7, 2007) is that a "listed transaction" will be considered "undisclosed" unless Form 8886 is filed either on the original return or is filed with a "qualified amended return". For purposes of a "listed transaction " an amended

return is not "qualified" unless filed before:

1. Date taxpayer is contacted by IRS for examination.

2. Date tax shelter promoter is contacted by IRS for examination under IRC § 6700 (penalty on promoter for promoting abusive shelters).

3. Date "pass-thru entity" is contacted by the IRS (for pass-thru tax item).

4. Date of summons to group including pass-thru entity or taxpayer.

*5. Date by which Commissioner announces a settlement initiative with respect to a listed transaction.

NOTE - The IRS HAS announced, in previous years, settlement initiatives for 419(A(f)(6) Welfare Plans and 412(i) Defined Benefit Plans. Thus, window on these is closed. As to 419(e) Welfare Plans (single employer) - I am not aware of any settlement initiative yet - thus AMEND or "face the music".

NOTE - The Reg indicates Commissioner may waive the requirements of the settlement initiative bar. What does that mean? It means the IRS is not barred by Congress from waiving the settlement initiative prohibition - although in our experience thus far - IRS Field Agents and their immediate supervisors say "No". Appeal to IRS Appeals might be needed - we are not far enough in that pipeline yet to know what happens at Appeal.

6. Date IRS contacts any person under IRC § 6707 for failure to report a "reportable transaction".

7. Date IRS requests from any person who made a tax statement to or for benefit of taxpayer, or gave taxpayer material advice with respect to the information required to include on a list under IRC § 6112 relating to a transaction same or similar to the undisclosed listed transaction (IRC § 6112 relates to lists required to be maintained by material advisors (IRC § 6111)).

TOUCH CHOICES! Chart follows:

Situation	What to do?
1. Client enters into "listed transaction". You find out. Return not prepared or filed	Insist on attaching Form 8886 or backing out deductions or both: Explain reasons to Taxpayers. 8886 also goes in on 1040 for S corporation owners or LLC members. CYA if client refuses. Seriously consider revising returns to back out the affected deduction.
2. Client enters into "listed transactions". Returns filed without 8886.	412(i) or 419A(f)(6) Determine why you were unaware of "listed transactions" to measure exposure for 412(i) and 419A(f)(6). Measure "pros" of disclosing transaction on Form 8886 (guaranteed audit?) when there is only a small chance IRS Commissioner may waive the "listed transaction" penalty - and most likely backing out the deductions--or not disclosing - thereby playing the audit lottery (remember they can - and have - gotten the "promoters" list. I was told IRS got a list of most of BISYS's 419A(f)(6) clients and is auditing all - and locally many of you know Xelan's list is under audit) but having no chance of getting penalty waived. NOTE - Developing area. A middle step is not filing 8886 but amending to delete deductions (a "listed transaction" requires a "deduction"). We are currently testing whether that "works" - although an IRS Field Agent told me if "deduction taken on the original return, amending to delete it does not matter." 419(e) Single Employer VEBA File amended return with 8886 - and for more protection - disallow deductions. NOTE- Also, per Notice 2007-83: file Form 8886 for all open years - must be filed by January 15, 2008.

Do Taxpayers and or Promoters Usually Blame the CPA for the Imposition of a "listed transaction penalty?

Absolutely! In experience of BUTTERFIELD SCHECHTER◆LLP, in connection with IRS audits and litigation against the promoter of these abusive employee benefit products - standard litany is: "we just sold the product and the plan, the filing of the Form 8886 is your accountant's responsibility"! Even though the client usually is clueless as to what a "listed transaction" is - much less able to articulate to his/her CPA the fact he/she entered into an abusive tax shelter.

NOTE - Virtually all of these deals involve an insurance or financial person promoting these deals, assuring the client of wonderful tax write-offs and great financial/tax benefits and at the last moment (see form later) asking client to sign - in the flurry of paperwork needed to sign up for the program - to sign a disclaimer form to protect the promoter - the form usually says "you did not rely on the promoter for tax advice, obtained independent advice," and some also indicate "the transaction might be a listed transaction" (see later slide). There are almost never any oral disclosures - or written disclosures prior to the final signing session - to the effect that the client is entering into an abusive tax shelter and that penalties in the hundreds of thousands of $s can be imposed for failure to file Form 8886.

NOTE 2 - Virtually all (with exceptions) of the deals we've seen involve a CPA who just is "given pension/benefit #s" - and is uninvolved in the consulting process and also unaware of the nature of the particular benefit plan. The CPA claims ignorance of the situation - indicating he/she had no idea what taxpayer did was a "listed transaction" or was considered abusive in any way. This results in UGLY finger pointing situations - and possible litigation. Clients turn mean and nasty when penalties in the hundreds of thousands are imposed.

Examples of the Ugliness

Our firm has numerous examples of disclosure forms taxpayers sign, and litigation postures. A sampling follows (actual form):

"TAXPAYER DISCLOSURE OF LISTED TRANSACTION

Name of Employer: ____

Federal Identification Number: ____________________

Name of Plan: ______________________________

Plan Administrator: ____________________________

____

I, the undersigned on behalf of the employer named above, hereinafter called the "EMPLOYER", hereby acknowledge and agree as follows:

1. I am duly authorized and empowered to execute this Acknowledgment and Waiver on behalf of said EMPLOYER;

2. The EMPLOYER has established a welfare benefit plan under the provisions of Internal Revenue Code section 419A(f)(6), and the Penn Mutual Life Insurance Company has issued or will issue life insurance policy(s) pursuant to the terms and provisions of said plan;

3. Under the provisions of Internal Revenue Code section 6011 and the Regulations thereunder, welfare benefit plans purporting to comply with the provisions of Internal Revenue Code section 419A(f)96) may be considered "listed transactions", and therefore, the EMPLOYER may be required to file IRS Form 8886 - Reportable Transaction Disclosure Statement with its federal income tax return;

4. The provisions of American Jobs Creation Act of 2004 enacted on October 22, 2004 impose substantial monetary fines and tax penalties for noncompliance with the taxpayer disclosure requirements of Internal Revenue Code section 6011;

5. The EMPLOYER has relied solely and exclusively on the opinion and advise of its independent legal and tax advisors with respect to all matters relating to said plan, including, but not limited to the disclosure requirements and tax consequences of said plan;

6. Neither the Penn Mutual Life Insurance Company nor any of its agents, representatives, or employees have provided any legal or tax opinion or advise with respect to the tax consequences of the plan, taxpayer disclosure requirements, or the application and effect of the Employee Retirement Income Security Act of 1974 (ERISA) respecting the plan;

7. The undersigned EMPLOYER hereby agrees to indemnify and hold harmless the Penn Mutual Life Insurance Company and its agents, representatives, or employees from any and all liability obligation or responsibility whatsoever directly or indirectly relating to or resulting from the establishment, operation, or administration of the plan, the taxpayer disclosure requirements respecting said plan or the fines and penalties for noncompliance with said disclosure requirements and the tax consequences of said plan.

Date: ____________________ NAME OF EMPLOYER

____

ATTEST: SIGNED: ____________________________

TITLE: ____________________________

And in litigation, the insurance company usually claims its agent was a "cowboy" - acting improperly. See the following excerpt from Hartford Insurance Company's "answer" in litigation:

"THIRD AFFIRMATIVE DEFENSE

No Reasonable Reliance

Defendants assert that Plaintiffs had the resources to engage, and did in fact engage, the services of independent advisors and experts to advise and assist them in conjunction with the events alleged in the Complaint. Defendants allege that Plaintiffs relied upon the advise and expertise of their own advisors in connection with the activities alleged in the Complaint. In addition, Defendants allege that Plaintiffs took tax deductions for Welfare benefit plan contributions and took other actions knowing they freely and voluntarily assumed the tax risks and other risks and consequential injuries and damages, if any, and could not and did not reasonably rely on any purported misrepresentation, inaction, advise or purported expertise of Defendants."

What can you do to protect yourself Given the new paradigm that Insurance Agents - at least in this arena - are not your friends, are not fiduciaries of the taxpayer, and are hell-bent to market and sell abusive tax shelters to you and your clients - knowingly or not?

NOTE - Given some CPAs now sell product - participating in the advising and promotion of this type of Program from an investment fee perspective means litigators will almost certainly want to name you as a party Defendant. As it stands, even if you have no involvement in the investment side of this - you are likely to be named as a Defendant.

COVER YOUR BUTT!!!! Consider two things:

1. Amend your engagement letter (this is unlikely to work if you materially participated in the consulting and/or investment side of the listed transaction) to say something to the effect:

Acme CPAs does not in the gathering of data to prepare your returns (1040, 1120, 1065, etc.) independently investigate to determine whether the contributions reported to us by your Qualified Plan or Benefit Program Consultants, Insurance Agent or Third Party Administrators are to a program designated by the IRS as a "listed transaction" (i.e. abusive tax shelter). Penalties for unreported "listed transactions" can be $200,000 or more per year.

We merely take information from others - the tax qualifications and other attributes of the benefit programs you contribute to are not our responsibility. Our firm can assist you upon request to review your benefit programs - and we will if deemed advisable - assist you to

obtain independent advice from qualified benefit advisors. The types of benefit programs particularly susceptible to "listed transaction" penalties generally are (1) 412(i) fully insured Defined Benefit Plans with life insurance (2) 419A(f)(6) multiemployer Welfare/VEBA Plans and (3) single employer 419(e) Welfare/VEBA Plans (not a complete list).

2. Annual Questions in your Questionnaire to Clients:

Examples:

1. Did you establish or do you maintain any benefit plans of the following types during 2007?

A. 412(i) fully insured Defined Benefit Plan with life insurance. Yes ____ No ____

B. 419A(f)(6) Welfare Plan/VEBA. Yes ____ No ____

C. 419(e) Welfare Plan/VEBA. Yes ____ No ____

D. Any other type of benefit program involving life insurance or disability insurance premiums other than a "plain vanilla broad coverage" Section 79 Group life insurance plan or group disability plan. Yes ____ No ____

3. Get Suspicious!

Do you have a client 32 years old whose Pension consultant sends you a letter telling you the 2007 pension deduction is $200,000+ (even $100,000+)? Do you have a client who is deducting any amount to a benefit program that involves life insurance above and beyond any "vanilla" nominal amounts? Has the Pension consultant told you your client can put in large amounts into benefit programs solely benefitting your client without covering other employees you think normally would be covered under a typical 401(k) Plan? Are you hearing anything that sounds "too good to be true?" Is someone telling you he/she has a benefit program few know about - and that he/she alone in the USA possesses knowledge about big deductions to benefit plans that no one else has?

A YES - to any or all of the above questions should lead you to ask yourself whether further investigation or added "CYAing" is advisable.

REMEMBER - the $ stakes are huge here!! A client subjected to huge listed transaction penalties is likely to turn into an ugly Plaintiff. And your malpractice policy may or may not cover you for amounts you owe after a Court battle for "listed transactions." You may believe overlooking "listed transactions" is not negligence. But I guarantee you some Courts and Juries will not see it that way. Do you want to "play chicken" with these penalties? Not advised!!