

employee plans news

PROTECTING RETIREMENT BENEFITS THROUGH EDUCATING CUSTOMERS

Internal Revenue Service
Tax Exempt and Government
Entities Division

A Publication of Employee Plans

EP Launches Web Section on Abusive Tax Shelter Schemes

As part of its effort to combat abusive tax shelter schemes and transactions, Employee Plans has launched a new Web section containing important information about abusive schemes involving employee retirement plans. The section warns promoters and plan professionals about the consequences of participating in such schemes. It also provides a hotline for reporting suspected abusive transactions to the IRS.

The “EP Abusive Tax Transactions” section is on the [Retirement Plans web page](#). The section identifies so-called “listed transactions” involving employee retirement plans and provides recently issued guidance – such as Treasury regulations and IRS revenue rulings – intended to shut down transactions the IRS deems abusive.

“Employees and retirees count on the reliability of employee plans, which are overseen by the IRS,” said Mark W. Everson, Commissioner of Internal Revenue. “We are providing this information so law-abiding plan professionals and participants can avoid being duped by promoters of abusive schemes that endanger the integrity of employee retirement plans.”

A listed transaction is one that is identical or substantially similar to one the IRS has determined to be a tax avoidance transaction by published guidance. Recently identified listed transactions include a scheme involving indirect contributions to Roth IRAs, certain S corporation ESOPs (employee stock ownership plans) and certain section 412(i) plans. •

New Abusive Tax Shelter Guidance

In recent weeks, the Treasury and the IRS have taken a number of steps to curb tax avoidance transactions in the employee benefits area by designating certain transactions, as well as substantially similar transactions, as “listed transactions.” As a result, they must comply with the tax-shelter disclosure and list maintenance requirements.

Tom Terry, Senior Technical Advisor to the TE/GE Commissioner, said, “Each piece of guidance – in conjunction with our new Web section on abusive tax schemes involving retirement plans – confirms our commitment to maintaining the integrity of retirement plans.”

To shut down abusive Roth IRA transactions, [Notice 2004-8](#) describes certain transactions entered into by individuals, their Roth IRAs, and their businesses where value is shifted into a Roth IRA in excess of the contribution limits. Following are two examples of transactions covered by Notice 2004-8:

Example 1 John Smith is a dentist who has operated his dental practice as a sole proprietorship for several years. In 2003, Dr. Smith opened a Roth IRA with his bank and contributed \$3,000 to the account, the maximum he could contribute under the Internal Revenue Code. The Roth IRA acquired 100% of the stock of a newly-formed corporation for \$1,000. The corporation had few assets at the time of the acquisition. Shortly after the corporation was acquired by the Roth IRA, Dr. Smith’s sole proprietorship sold its accounts receivable to the newly-formed corporation for \$2,000 although the fair market value of these accounts at the time of the sale was \$10,000. Later in the year, the proceeds from the accounts receivable were received by the newly-formed corporation and distributed to the Roth IRA as the sole shareholder of the corporation. The proceeds from the accounts receivable were taxed to the newly-formed corporation at the applicable corporate tax rate but no tax was paid on the distribution of the proceeds to the Roth IRA on the grounds that the income of a Roth IRA is not subject to tax. Dr. Smith anticipates receiving a tax-free distribution of the proceeds from the Roth IRA (plus any earnings on the proceeds) in a later year.

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Example 2 Mary Jones is a doctor who has operated her medical practice as a solely-owned corporation for several years. In 2002, Dr. Jones opened a Roth IRA and contributed \$1,000 to the account. Shortly after the contribution was made, the Roth IRA acquired 100% of the stock of a newly-formed corporation. In 2003, Dr. Jones entered into an agreement with the corporation which provided that she would provide the same services to the new corporation as she had provided to the solely-owned corporation, with the new corporation receiving payment for such services. The agreement provided that she would be paid \$50,000 per year although she had earned \$200,000 per year in each of the prior two years for these services. In accordance with the agreement, in 2003, Dr. Jones performed the same services she had performed in prior years and received \$50,000 in 2003 from the newly-formed corporation, while the new corporation retained \$150,000 of the \$200,000 received in connection with such services. The amounts received by the new corporation were distributed to the Roth IRA in 2004 as the sole shareholder. If Dr. Jones had received the \$200,000 as earnings in 2004, she could not have made a contribution to the Roth IRA. The amounts received by the new corporation were taxed to the corporation at its corporate tax rate but no tax was paid on the distribution to the Roth IRA and Dr. Jones paid taxes only on the \$50,000 received for her services. Dr. Jones anticipates receiving a tax-free distribution of the proceeds from the Roth IRA in a later year.

The above are just two examples of the types of transactions that are now treated as “listed transactions”.

To shut down abusive 412(i) plan transactions, [Rev. Rul. 2004-20](#) – one of four new pieces of guidance pertaining to section 412(i) plans (the others being a proposed regulation, a revenue procedure on fair market value, and a revenue ruling on non-discrimination) – concerns the deductibility of certain contributions. Below is an example of a situation envisioned by Rev. Rul. 2004-20:

Example 3 Sue Brown is a doctor who operates her medical practice as a solely-owned corporation. Sue Brown participates in the section 412(i) pension plan maintained by her corporation. The pension plan provides a \$1,400,000 death benefit, payable upon the death of Ms. Brown, to her beneficiaries. Although the death benefit is equal to \$1,400,000, the plan purchased a life insurance policy with a face value of \$5,000,000. The plan provides that if Ms. Brown dies while she is employed by the corporation, \$1,400,000 is payable to her beneficiaries but the remaining \$3,600,000 is to be applied to pay premiums under the plan for other participants. The employer corporation deducted the contributions paid to the plan that were used to pay the premiums on the full amount of the insurance policy.

As with Examples 1 and 2 above, Example 3 is just one type of transaction that will be treated as a “listed transaction”.

Finally, **to shut down abusive ESOP transactions**, [Rev. Rul. 2004-4](#) describes certain transactions that, in violation of the requirements of Code section 409(p), divert value away from an employee stock ownership plan’s interest in an S corporation. Rev. Rul. 2004-4 describes three structures that violate the requirements of section 409(p), which generally protects the interests of rank-and-file participants in an S corporation ESOP.

A detailed list of guidance published by the IRS prior to 2004 pertaining to various types of transactions designated as “listed transactions” can be found in [Notice 2003-76](#).

New User Fees for Employee Plans Technical Requests

[Revenue Procedure 2004-8](#) changed the user fees required for most types of requests sent to EP Technical in Washington, DC. Such requests include requests for private letter rulings, waivers, opinion letters for master and prototype plans, and opinion letters for prototype IRAs, SEPs, SIMPLE IRAs and Roth IRAs. The increased user fees are effective for requests submitted on or after January 20, 2004. Anyone who plans to submit such a request to EP Technical should first check the fee schedule in Rev. Proc. 2004-8 to determine the correct user fee required to be included with the request.

There is no change in the user fees required for requests for Employee Plans determination letters submitted to the IRS Service Center in Covington, KY.

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