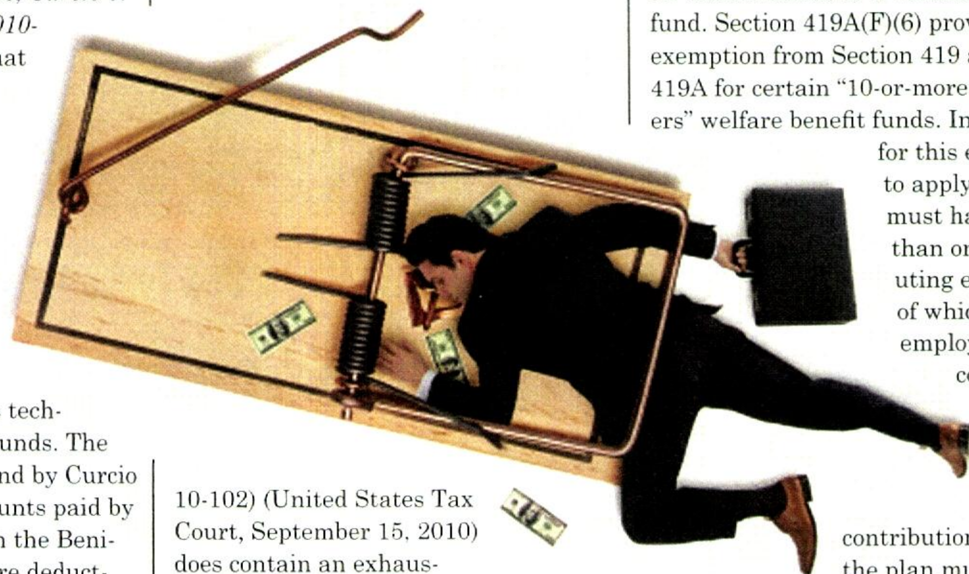
 by *Lance Wallach*

412i, 419, Captive Insurance and Section 79 Plans; Buyer Beware

The IRS has been attacking all 419 welfare benefit plans, many 412i retirement plans, captive insurance plans with life insurance in them, and Section 79 plans. IRS is aggressively auditing various plans and calling them "listed transactions," "abusive tax shelters," or "reportable transactions," participation in any of which must be disclosed to the Service. The result has been IRS audits, disallowances, and huge fines for not properly reporting under IRC 6707A.

In a recent Tax Court Case, *Curcio v. Commissioner (TC Memo 2010-115)*, the Tax Court ruled that an investment in an employee welfare benefit plan marketed under the name "Benistar" was a listed transaction. It was substantially similar to the transaction described in IRS Notice 95-34. A subsequent case, McGehee Family Clinic, largely followed Curcio, though it was technically decided on other grounds. The parties stipulated to be bound by Curcio regarding whether the amounts paid by McGehee in connection with the Benistar 419 Plan and Trust were deductible. Curcio did not appear to have been decided yet at the time McGehee was argued. The McGehee opinion (Case No. 10-102) (United States Tax Court, September 15, 2010) does contain an exhaustive analysis and discussion of virtually all of the relevant issues.



Taxpayers and their representatives should be aware that the Service has disallowed deductions for contributions to these arrangements. The IRS is cracking down on small business owners who participate in tax reduction insurance plans and the brokers who sold them. Some of these plans include defined benefit retirement plans, IRAs, or even 401(k) plans with life insurance.

In order to fully grasp the severity of the situation, you have to understand Notice 95-34. It was issued in response to trust arrangements that were sold to companies designed to provide deductible benefits, such as life insurance, disability and severance pay benefits. The promoters of these arrangements claimed that all employer contributions were tax-deductible when paid. They relied on the 10-or-more-employer exemption from the IRC § 419 limits. They claimed that that permissible tax deductions were unlimited in amount.

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In general, contributions to a welfare benefit fund are not fully deductible when paid. Sections 419 and 419A impose strict limits on the amount of tax-deductible prefunding permitted for contributions to a welfare benefit fund. Section 419A(F)(6) provides an exemption from Section 419 and Section 419A for certain "10-or-more employers" welfare benefit funds. In general, for this exemption to apply, the fund must have more than one contributing employer, of which no single employer can contribute more than 10% of the total contributions. Also, the plan must not be experience-rated with respect to individual employers.

According to the Notice, these ar-

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