



IRS Nationwide  
**Tax Forum** | 2023

# Abusive Tax Avoidance Transactions

Rev. 06/27/2023

At the end of this session you will be able to:

- Identify the steps the IRS is taking to address abusive tax promotions
- Describe how to report abusive promotions and abusive return preparers to the IRS

# Promoter

## Definition:

- Person who organizes, promotes, sells, implements, insures, carries out, or assists in the organization, promotion or sale of an abusive tax avoidance transaction
- A promoter also may be referred to as a material advisor

# Abusive Tax Avoidance Transaction

## Definition:

- An entity, plan, arrangement, scheme or series of transactions that result in improper tax avoidance
- The transaction misinterprets the Internal Revenue Code in a way that is inconsistent with its meaning
- Also known as an abusive tax transaction or an abusive transaction

# IRS Promoter Strategy

- Coordinate promoter investigation activities across the IRS
- Investigate abusive promotions and abusive tax return preparers
- Communicate with all stakeholders and the public about abusive tax promotions and abusive return preparers



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# Coordinate Activities

# Office of Promoter Investigations

- It is critical to improve ability of IRS to identify and deter promoters
- IRS must stop the transaction before the promoter can widely market the transaction
  - Most efficient use of IRS resources
  - Prevent taxpayers from engaging in abusive transactions

# Service-wide Approach

- Coordinate compliance efforts of different business operating divisions
- Understand how abusive activities affect each business operating division
- Convene a team of experts to create a strategic task force to investigate the abusive scheme and take appropriate action



# Data Analytics

Build data models to detect promoter activity without audits

- Recognize potential abusive tax promotions
- Use data analytics to identify
  - Promoters
  - Return preparers
  - Others who facilitate abusive tax transactions



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# Investigate the Promotion

# Investigate the Whole Promotion

- Initial focus will be the promoter of the abusive transaction
- Expand investigation to those who enable the transaction
  - Accountants
  - Actuaries
  - Appraisers
  - Attorneys
  - Return preparers

# Promoter and Enabler Compliance

- Assess all applicable penalties
- Refer to Criminal Investigation
- Refer to the Department of Justice for injunctions and/or disgorgement
- Refer to the Office of Professional Responsibility
- Suspend or revoke participation in IRS e-file

# Taxpayer Compliance

- Opportunity to self-correct
- Audits, with the assessment of all applicable civil penalties
- Referrals to Criminal Investigation



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Communicate

# Engage Internal Partners

- Organizational approach to abusive tax avoidance transactions
- Goal is to ensure as much information as possible obtained by one function within the IRS can be leveraged by other functions

# Engage External Partners

- State tax authorities
- Tax practitioner community – mutual benefit for IRS and tax practitioners to work together
- Compliant tax practitioners should not have to compete with abusive promoters and return preparers who enable the abusive transactions

NOTE: Partnerships limited by the disclosure rules



# Lead Development Center Referrals

- Report information on any abusive tax transaction to the IRS using Form 14242, Reporting Abusive Tax Promotions and/or Preparers
- Form contains instructions for sending it to the Lead Development Center
- Additional information available on [irs.gov](https://www.irs.gov)

# Revised Publication 3995

- Publication 3995, Recognizing Illegal Tax Avoidance Schemes
- Tri-fold brochure that explains unlawful tax avoidance schemes and how to refer promoters to the Lead Development Center
- Available in English, Spanish and Mandarin

# Whistleblower Claims

- Information on abusive tax transactions also can be sent to the IRS Whistleblower Office for potential reward
- Use Form 211, Application for Award for Original Information
  - The form has directions for sending the form to IRS
  - More information available on [irs.gov](https://www.irs.gov)

# Dirty Dozen Abusive Promotions

2023 Dirty Dozen Schemes Discussed in this Presentation:

- Employee Retention Credit
- Micro-Captive Insurance
- Syndicated Conservation Easements
- Charitable Remainder Annuity Trusts



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# Employee Retention Credit (ERC)

# ERC

- Promoters advising ineligible taxpayers to claim credit
- New 2023 entry on the Dirty Dozen list, IR-2023-49, March 20, 2023
- Employers improperly receiving the credit could have to repay the credit *plus additional interest and possible penalties*

## Alert 2023-02

- Office of Professional Responsibility Alert 2023-02, 3/7/2023, professional obligations for ERC claims
- If practitioner has reason to believe claim is overstated, advise client of potential penalties and assist client with correcting or mitigating the problem, if requested by client
- Consider informing client to complain using Form 14242

# IR-2023-105

May 25, 2023: IRS alerts businesses, tax-exempt groups of warning signs for misleading Employee Retention scams; simple steps can avoid improperly filing claims



# IR-2023-105 – Commissioner Quote

“The aggressive marketing of the Employee Retention Credit continues preying on innocent businesses and others ... Aggressive promoters present wildly misleading claims about this credit. They can pocket handsome fees while leaving those claiming the credit at risk of having the claims denied or facing scenarios where they need to repay the credit.”

– Commissioner Danny Werfel

# Aggressive Marketing, 1 of 3

- Unsolicited calls or advertisements mentioning an "easy application process."
- Statements that the promoter or company can determine ERC eligibility within minutes
- Large upfront fees to claim the credit

# Aggressive Marketing, 2 of 3

- Fees based on a percentage of the refund – a warning sign for all taxpayers who should always avoid a tax preparer basing their fee on the size of the refund
- Wildly aggressive suggestions from marketers urging businesses to submit the claim because there is nothing to lose

# Aggressive Marketing, 3 of 3

- Aggressive claims from the promoter that the business receiving the solicitation qualifies before any discussion of the group's tax situation. Employee Retention Credit is a complex credit that requires careful review before applying

# Promoters Lure Victims

- Aggressive marketing
- Direct mailing
- Leaving out key details
- Payroll Protection Program participation

# Taxpayers Can Protect Themselves

- Work with trusted tax professionals
- Only taxpayers that legitimately believe they are entitled to the credit should apply



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# Refer ERC Promoters to the LDC

- Use Form 14242, Report Suspected Abusive Tax Promotions or Preparers
- Mail:
  - Internal Revenue Service Lead Development Center
  - Stop MS5040
  - 24000 Avila Road
  - Laguna Niguel, California 92677-3405
- Fax: 877-477-9135



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# Micro-Captive Insurance



# Micro-Captive Insurance Companies

Internal Revenue Code section 831(b) allows certain insurance companies to elect only to be taxed on their investment income

- Entity must be an insurance company, other than a life insurance company
- Net written premiums do not exceed the specified amount, currently \$2.65 million
- Entity meets diversification requirements

# Abusive Micro-Captives, 1 of 2

- Key focus of IRS enforcement
- Insured business sets up a Micro-Captive to insure purported risks
- Taxpayer may know nothing about the insurance business
- Taxpayer hires a captive manager to facilitate the transaction



# Abusive Micro-Captives, 2 of 2

- Taxpayer retains commercial insurance policies while taking on the new captive policies that may insure implausible risks
- Arrangement generates large insurance premium expense deductions
- Captive pays little to no claims

# Proposed Regulations – 04/11/2023

- Identifies certain micro-captive transactions as listed transactions
- Identifies certain micro-captive transactions as transactions of interest
- 88 FR 21547

# Settlement Initiative

- Micro-Captive Resolution settlement offered to eligible taxpayers under examination in 2019
- Offers taxpayers an opportunity to close down their captive in exchange for reduced adjustments and penalties
- A second settlement remains open

# Reserve Mechanical Corp.

Reserve Mechanical Corp. v. Commissioner, T.C. Memo. 2018-86, aff'd, 34 F.4<sup>th</sup> 881 (10<sup>th</sup> Cir. 2022)

- Captive not engaged in insurance business
  - No risk distribution
  - Policies not insurance in commonly accepted sense



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# Syndicated Conservation Easements

# Conservation Easement

Conservation easement – a voluntary agreement between a landowner and another entity that limits the use, modification or development of the property

- Value of easement is difference between the value of the property with and without the easement restriction
- If various requirements are met, taxpayers may claim a charitable contribution deduction for the value of the easement



# Syndicated Conservation Easement

Syndicated conservation easement (SCE) – a promoter offers investors the possibility of a charitable contribution deduction that significantly exceeds the amount invested

- Taxpayers invest in pass-through entities, such as limited liability companies and partnerships
- Structure often use multiple tiers of entities

# Abusive SCE Arrangements

- Key focus of IRS enforcement
- Use inflated appraisals
- Investors typically promised \$2.50 or more in deductions for each \$1 invested

# IRS Compliance Activities

Service-wide compliance efforts by SCE groups

- Groups audit participants and only work SCE cases
- Investigations of
  - Appraisers
  - Promoters
  - Attorneys
  - Return preparers

# Proposed Regulations – 12/08/2022

- Identifies certain syndicated conservation easement transactions as listed transactions
- 87 FR 75185

# Legislative Change

- December 27, 2022 – SECURE 2.0 Act of 2022 enacted
- Applies to contributions made after 12/29/2022
- Section 605 of the Act disallows conservation easement deductions that exceed 2.5 times the sum of each partner's relevant basis in the partnership
- Understatement treated as a gross valuation misstatement subject to 40 percent accuracy penalty under IRC 6662

# Safe Harbor Deed Language

- April 10, 2023: IR-2023-73, safe harbor deed language for extinguishment and boundary line adjustment clauses
- Notice 2023-30 – provides safe harbor deed language clauses required by Secure 2.0 Act of 2022
  - Donors not required to amend the deeds
  - July 24, 2023 deadline to record deed amendments

# SCE Injunction

March 20, 2023 the U.S. District Court for the Northern District of Georgia issues a permanent injunction



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# Charitable Remainder Annuity Trusts



# Charitable Remainder Trusts

- Irrevocable trusts that lets individuals donate assets to charity and draw annual income for life or for a specific time period
- Must meet specific requirements of Internal Revenue Code section 664 and the Treasury Regulations
- Charitable Reminder Annuity Trust – CRAT

## Qualified CRAT

- Trust must pay a non-charitable beneficiary a fixed annual annuity over a specified number of years
- Donor does not recognize gain or loss on the transfer of the asset to the trust
- Trust acquires carryover basis from the donor
- Trust income is taxable to the beneficiary when distributed

## Qualified CRAT, continued

- At the conclusion of the annuity period the trust transfers the remaining assets to a charity
- In the year the trust was created, the donor receives a charitable contribution deduction
  - Deduction subject to AGI percentage limitations
  - Deduction equals the value of the property less the present value of the annuity payments

# Abusive CRAT Scheme

- Trust structure does not meet the legal requirements
  - Annuity payment to beneficiary is not fixed
  - Allows trustee to prepay and liquidate the charitable beneficiary's interest in the trust assets
- Trust claims a stepped-up basis for contributed assets
- Trust may fail to report sale of assets or reports no gain

## Abusive CRAT Scheme, continued

- Trustee purchases a commercial single-premium immediate annuity to fund the required beneficiary distributions
- Scheme recharacterizes distributions of trust income into the non-taxable return of the investment in the annuity by asserting the transaction is taxable under section 72 rather than under section 664
- AM 2020-006 contains a detailed discussion of the abusive aspects of the scheme

# CRAT Injunctions

United States District Court for the Western District of Missouri issues stipulated permanent injunctions

- January 18, 2023
- March 24, 2023
- May 17, 2023

# Summary

- Promoters perpetrate their schemes at the expense of taxpayers and tax practitioners
- Unchecked promoters of abusive tax avoidance transactions undermine the IRS mission
- The IRS promoter strategy protects taxpayers and the U.S. Treasury by stopping tax loss sooner



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Forms, Pubs, Resources, Links



# Resources, 1 of 6

- Publication 3995, Recognizing Illegal Tax Avoidance Schemes
  - English: [irs.gov/pub/irs-pdf/p3995.pdf](https://irs.gov/pub/irs-pdf/p3995.pdf)
  - Spanish: [irs.gov/pub/irs-pdf/p3995sp.pdf](https://irs.gov/pub/irs-pdf/p3995sp.pdf)
  - Mandarin (to be available summer 2023):

## Resources, 2 of 6

- Dirty Dozen  
[www.irs.gov/newsroom/dirty-dozen](http://www.irs.gov/newsroom/dirty-dozen)
- IR-2023-49, March 20, 2023  
[www.irs.gov/newsroom/irs-opens-2023-dirty-dozen-with-warning-about-employee-retention-credit-claims-increased-scrutiny-follows-aggressive-promoters-making-offers-too-good-to-be-true](http://www.irs.gov/newsroom/irs-opens-2023-dirty-dozen-with-warning-about-employee-retention-credit-claims-increased-scrutiny-follows-aggressive-promoters-making-offers-too-good-to-be-true)

# Resources, 3 of 6

- Office of Professional Responsibility alert 2023-02, 3/7/2023  
<https://content.govdelivery.com/accounts/USIRS/bulletins/34d3150?reqfrom=share>
- IR-2023-105, May 25, 2023  
<https://www.irs.gov/newsroom/irs-alerts-businesses-tax-exempt-groups-of-warning-signs-for-misleading-employee-retention-scams-simple-steps-can-avoid-improperly-filing-claims>

## Resources, 4 of 6

- IR-2023-73, April 10, 2023, Treasury, IRS issue safe harbor deed language for extinguishment and boundary line adjustment clauses

[www.irs.gov/newsroom/treasury-irs-issue-safe-harbor-deed-language-for-extinguishment-and-boundary-line-adjustment-clauses](https://www.irs.gov/newsroom/treasury-irs-issue-safe-harbor-deed-language-for-extinguishment-and-boundary-line-adjustment-clauses)

## Resources, 5 of 6

- Notice 2023-30, Conservation Easements – Safe Harbor Deed Language for Extinguishment and Boundary Line Adjustment Clauses  
[www.irs.gov/pub/irs-drop/n-23-30.pdf](http://www.irs.gov/pub/irs-drop/n-23-30.pdf)
- AM-2020-006, Charitable Remainder Annuity Trust Structure, June 26, 2020  
[www.irs.gov/pub/lanoa/am-2020-006.pdf](http://www.irs.gov/pub/lanoa/am-2020-006.pdf)

## Resources, 6 of 6

- Court Permanently Bars Five Defendants From Promoting Charitable Remainder Annuity Trust Tax Scheme  
<https://www.justice.gov/opa/pr/court-permanently-bars-five-defendants-promoting-charitable-remainder-annuity-trust-tax>

# Resources, IRC Sections

IRC section 72 – Annuities; certain proceeds of endowment and life insurance contracts

IRC section 664 – Charitable remainder trusts

## Resources, IRC Sections, cont'd.

IRC section 831 – Tax on insurance companies other than life insurance companies

IRC section 6662 - Imposition of accuracy-related penalty on underpayments



# Resources – Proposed Regulations 1

88 FR 21547 – Micro-captive transactions

[www.federalregister.gov/documents/2023/04/11/2023-07315/micro-captive-listed-transactions-and-micro-captive-transactions-of-interest](http://www.federalregister.gov/documents/2023/04/11/2023-07315/micro-captive-listed-transactions-and-micro-captive-transactions-of-interest)

# Resources – Proposed Regulations 2

87 FR 75185 – Syndicated conservation easement transactions

[www.federalregister.gov/documents/2022/12/08/2022-26675/syndicated-conservation-easement-transactions-as-listed-transactions](https://www.federalregister.gov/documents/2022/12/08/2022-26675/syndicated-conservation-easement-transactions-as-listed-transactions)

# Resources – Forms

Form 14242, Report Suspected Abusive Tax Promotions or Preparers

- English: [irs.gov/pub/irs-pdf/f14242.pdf](https://irs.gov/pub/irs-pdf/f14242.pdf)
- Spanish: [irs.gov/pub/irs-pdf/f14242sp.pdf](https://irs.gov/pub/irs-pdf/f14242sp.pdf)
- Mandarin: [irs.gov/pub/irs-pdf/f14242cn.pdf](https://irs.gov/pub/irs-pdf/f14242cn.pdf)

# Resources – Forms, continued

- Form 211, Application for Award for Original Information  
[irs.gov/pub/irs-pdf/f211.pdf](https://irs.gov/pub/irs-pdf/f211.pdf)
- Form 211-A, State or Local Law Enforcement Application for Reimbursement for Original Information  
[irs.gov/pub/irs-pdf/f211a.pdf](https://irs.gov/pub/irs-pdf/f211a.pdf)

# Resources – Webpages

## Lead Development Center

[irs.gov/businesses/small-businesses-self-employed/abusive-tax-schemes-and-abusive-tax-return-preparers-irs-lead-development-center](https://irs.gov/businesses/small-businesses-self-employed/abusive-tax-schemes-and-abusive-tax-return-preparers-irs-lead-development-center)

## Whistleblower Office

[irs.gov/compliance/whistleblower-office](https://irs.gov/compliance/whistleblower-office)

# Resources – Webpages, continued

## Tax Scams – How to Report Them

[irs.gov/businesses/small-businesses-self-employed/tax-scams-how-to-report-them](https://irs.gov/businesses/small-businesses-self-employed/tax-scams-how-to-report-them)

# Resources – Court Case

- Reserve Mechanical Corp. v. Commissioner, 34 F.4th 881 (10th Cir. 2022), affirm'g. T.C. Memo. 2018-86

# Resources – Injunctions, 1 of 2

- United States v. EcoVest Capital, Inc., Alan N. Solan, Robert M. McCullough, Ralph R. Teal, Jr., and Calud Clark III, Case 1:18-cv-005774-AT, filed on 03/20/2023, United States District Court for the Northern District of Georgia  
[www.justice.gov/tax/page/file/1575966/download](http://www.justice.gov/tax/page/file/1575966/download)



# Resources –Injunctions, 2 of 2

United States v. John Hugo Eickhoff, Jr., et al., Case No. 2:22-cv-04027-MDH:

- Eickhoff, Jr. and Hoffman Associates injunction: Document 133
- John William Gray II injunction: Document 117
- Damon T. Eisma injunction: Document 102

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Residential and Home Energy Credits	solar tax credit, energy efficient home improvement credit
E-file Forms 1099 With IRIS	IRIS tax portal, Information Returns Intake System, file 1099 online
Reporting suspected tax law violations	Form 3949-A, tax fraud report, abusive tax avoidance, IRS report fraud
Digital Assets	convertible virtual currency and cryptocurrency, stablecoins, NFTs