

## **New IRS Hit List Against Landlords – Part 1 (Proposed Regulations for 2007 and Beyond)**

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### **Selling Appreciated Properties Without Current Taxes?**

Of course there are legitimate methods to sell with little or no current taxation including the 1031 exchange (and certain trusts), however, there have been some aggressive tax and asset protection methods marketed to landlords over the past few years that were and now are ‘suspect’ or considered ‘illegal’. The IRS has noticed such transactions, and is now taking action to curb what it deems to be ‘tax evasion’.

### **Marketing Groups Selling Private Annuity (Trusts)**

In 2006 the I.R.S. has shut down certain tax and seminar marketers who have run afoul, and in 2007 the IRS is holding hearings to make new rules concerning certain private annuity tax transactions. If you have been involved in any of the transactions discussed below, contact a knowledgeable attorney (not a marketing seminar group) and take measured action to protect yourself and meet the threat.

### **New IRS Proposed Regulations for 2006-2007**

Beware that the IRS is making new law to control or preclude certain tax transactions that may affect landlords for 2006, 2007 and beyond. On October 17, 2006 the IRS issued Proposed Regulations 1.72-6(e) and 1.1001-1(j) covering certain annuity tax transactions entered into after *October 18, 2006*, and other types entered into after *April 18, 2007*. These new proposed regulations do not forgive certain private annuity trust transactions made prior to such dates, but will supply guidelines going forward.

### **The IRS “Dirty Dozen”& the IRS Naughty List™**

Tax audits for 2006 and 2007 will be up greatly as the IRS spends its new audit budget increase. Legal strategies to ‘protect assets’ or common schemes to avoid or even ‘reduce’ taxes may face new challenges as the IRS places more and more common strategies in the ‘**suspect**’ or ‘**listed transaction**’ category. As the overall list grows, the author will add it to his IRS *NAUGHTY LIST™*. You must realize that yesterday’s commonly accepted ‘legal’ strategies to protect assets or reduce taxes may now be viewed as illegal or impotent.

As you may know, every year the IRS maintains and amends a list of what it deems to be tax scams (also called “listed transactions”). It was first termed the **IRS “DIRTY DOZEN”**. This overall ‘suspect’ and ‘listed transaction’ warning is now some **31 items and growing!** Taxpayers are required to file *Federal Form 8886* and voluntarily disclose involvement with any ‘listed transaction’. Involvement with tax scams can result in possible “imprisonment and fines” for you and the professional advisor. In addition to enforcing taxpayer or tax promoter violations of the ‘*listed transactions*’, the IRS is launching a \$100 million research project to audit more small businesses, especially sub-chapter “S” corporations and ESOP abuses. The IRS will also highly scrutinize landlords or business owners who have implemented certain “private annuity (trusts), “employee leasing”, abusive employee benefit and medical plans, life insurance and pension scams,

abusive indirect ROTH IRA contribution transactions, among others. Some of the listed scams and suspect transactions are:

### **Avoiding or Deferring Tax on Sale of Assets (Rental Properties & Private Annuity Trusts) Hands Off - Private Annuity Trusts!**

*Selling without current taxes?* Use of the **Private Annuity (Trust)** to transfer appreciated assets to a trust for the purpose of avoiding or deferring taxable gains on the sale are ‘suspect’ and may be deemed ‘tax evasion’. The IRS may disregard the ‘form’ of the transaction or its structure if it finds a lack of ‘economic substance,’ a ‘step transaction’ or for other reasons. Judges may also find ‘intent to defraud creditors’ in a litigation context, causing potential loss of assets or personal liability. Although there are legitimate purposes and uses for such transactions, annuities or trusts, the IRS will conduct **hearings in early February 2007** prior to issuing new rules governing same. We will update you on those hearings and new rules in Part 2 of this article. Meanwhile, if you have been involved in any such transaction you should contact an attorney to take action to safeguard your position. *It is possible that your private annuity (trust) may be subject to workout, repair or corrected implementation.* You need to take action to address this matter.

### **Offshore Business Insurance “Deduction” Scams Hands Off - Financial Marketing Scams**

Beware of tax promoters and transactions that promise that you can get a *business deduction for insurance premium payments to an offshore insurance company*, who then make a “distribution” (or return) to your ‘offshore trust’. This type of transaction will be under (criminal) review.

### **“Trust Misuse”**

#### **Hands Off - Certain Trusts!**

The IRS is actively examining professionals who, and transactions that “...promise reduction of income subject to tax, deductions for personal expenses and reduced estate or gift taxes.”

### **“Offshore Transactions” & U.S. Citizens**

#### **Hands Off - “Offshore”!**

“Experts estimate that Americans now have more than \$1 trillion in assets offshore and *illegally evade between \$40 and \$70 billion in U.S. taxes each year through the use of offshore tax schemes.*” {Emphasis added} [Tax Haven Abuses, The Enablers, The Tools and Secrecy, August 1, 2006, U.S. Senate Committee on Homeland Security and Governmental Affairs, Norm Coleman, Chairman, Carl Levin, Ranking Minority Member].

“[I]ndividuals continue to try to avoid U.S. taxes by illegally hiding income in offshore bank and brokerage accounts or using offshore credit cards, wire transfers, foreign trusts, employee leasing schemes, private annuities or life insurance to do so. The IRS...continues to *aggressively pursue taxpayers and promoters* involved in such abusive transactions.” {emphasis added}

### **Prohibited “Employment Tax Evasion” Programs Hands Off - “Employee Leasing Tax Schemes”**

Promoters of *employee leasing tax shelters* which would have you resign your employment position, open a foreign leasing company holding such employment rights, and open a deferred pension plan/trust, all designed to avoid or defer compensation and employment or income taxes, should expect an IRS or Justice (criminal) examination.

### **Prohibited Life Insurance (Swiss Annuity) Arrangements Hands Off - PPLI!**

Offshore Private Placement Life Insurance (PPLI) is on the IRS abusive attorney field advice list. A PPLI involves the use of variable universal life insurance (or Swiss Annuity or a variable annuity product), a dummy offshore insurance company which returns premiums back to the PPLI policy, and/or the selling of business interests to avoid taxes.

### **Business Entities vs. Personal Entities Hands Off - The Personal Use FLP/LLC!**

Even the commonly used family limited partnership (“FLP”) or Limited Liability Company (“LLC”) may be under attack. A ‘business’ entity used for ‘personal’ purposes may cause the entity to be held invalid altogether. The line of what a FLP/LLC can be used for is becoming troublesome. Such recharacterization may cause you and your client great expense, taxes, penalties, loss of assets, and personal liability. ***Remember, trusts are for personal uses, business entities are for business uses.***

### **What to Do?**

If you are in any such deals, hire counsel, identify the seriousness of your particular arrangement, take appropriate action which may include voluntarily disclosure of such involvement, workout or reversing the transaction, payment of any and all taxes and penalties, and documenting that you did not have an ill-intent. *Continued next month.*

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