

The 4 Most Dangerous Trends Facing Landlords™©2007 (Part II)

#2 - I.R.S. Traps & Trends™ - Update

Offshore Tax Traps & Trends!™

If you have implemented any offshore tax or asset protection plan, you should seek immediate legal review of your situation. The law will restrict offshore transactions or devices and subject you (grantor) to new IRS, SEC, banking, brokerage or credit reporting requirements.

Section 101 (new Subchapter F Section 7492 of the Internal Revenue Code of 1986) of the law would add rebuttable factual “*evidentiary presumptions*” in tax and securities proceedings that will automatically find facts against your interest. These facts include finding that you (U.S. grantor): (1) have exercised “*control*” over the entity; (2) have received previously ‘*unreported taxable income*’ in the year of any transfer (even if you call it a loan); (3) are the *beneficial owner and exercised control regardless if* you are not even listed as “owner” or “beneficiary”; (4) are *required to report and disclose* any account in an Offshore Secrecy Jurisdiction (even if below the current reporting FBAR amount of \$10,000). Non-U.S. witnesses may no longer submit evidence by declaration to support your rebuttal. They must appear in person with ‘clear and convincing evidence’. Section 101 also adds an “initial” list of **34 Offshore Secrecy Jurisdictions** that invoke the new legal requirements. The list is currently as follows subject to addition and change by the Treasury Secretary:

Anguilla	Cayman Islands	Isle of Man	Samoa
Antigua	Cook Islands	Jersey	St. Kitts
Barbuda	Costa Rica	Latvia Lichtenstein	Nevis
Aruba	Cyprus	Luxembourg	St. Lucia
Bahamas	Dominica	Malta	St. Vincent/ Grenadines
Barbados	Gibraltar	Nauru	Singapore
Belize	Grenada	Netherlands	Switzerland
Bermuda	Guernsey/Sark/Alderney	Antilles	Turks / Caicos
British Virgin Islands	Hong Kong	Panama	Vanuatu

Section 102 would add the same sanctions on the same types of entities by the Treasury as currently found in Section 311 of the Patriot Act (31 U.S.C. 5318(a)). It would also allow the ability to deny foreign banks the authority to issue *credit cards* for use in the United State. Section 103 extends by doubling the time the IRS has to investigate and assess additional taxes from 3 years to **6 years**. Section 104 would require disclosure of offshore accounts, transactions and entities by banks or securities (brokerage) firms – where it believes any “*beneficial owner*” of a foreign-owned financial account is a U.S. taxpayer. Section 105 does away with the so called “*trust protector*” concept or benefit. It attributes all powers and interests held by the trust protector to the maker or grantor of the trust. The *receiver or user* of any property or cash of a foreign trust (or entity or credit card) will be *treated as the beneficiary* of that trust or transaction. Taxable trust

distributions will now also include loans of real estate, marketable securities, and personal property of any kind, including artwork, furnishings and jewelry. Foreign trusts with current or future U.S. beneficiaries, including ***contingent U.S. beneficiaries will be considered taxable grantor trusts***. Legal opinions will no longer protect U.S. taxpayers under Section 106.

Section 201 increases the penalty of U.S. securities laws on public companies or their officers, directors or major shareholders to up to \$1,000,000 for failing to disclose offshore holdings reportable to the SEC (you may no longer be able to expect financial institutions ‘not’ to report you/offshore activity). Even private equity or hedge funds will have to report certain suspicious activity. 203 will impose reporting requirements to the “company formation agents”. Section 204 will enhance the John Doe summonses by allowing the court to “presume” that any summons concerning an Offshore Secrecy Jurisdiction has a ***reasonable basis to believe that the taxpayer has failed to comply with tax laws***. Section 205 improves enforcement of foreign account reporting in part by allowing the use of tax information in the investigations, uses highest balance to calculate FBAR penalties, and expressly allows Suspicious Activity Reports (SAS) to be used in civil as well as criminal, tax enforcement.

Domestic Traps & Trends

Title IV entitled, “Requiring Economic Substance” - Title IV entitled, Requiring Economic Substance, amends IRC 7701 with Section 401 entitled Clarification of Economic Substance Doctrine. This is a codification of the common law doctrine of substance over form. It holds that the ***“tax benefits are not allowed if the transaction (or series of transactions) does not have “economic substance” or “lacks a business purpose”***.

This section will not apply to personal transaction, but will apply to transactions entered into in connection with a trade or business or an activity engaged in for the production of income (such as rental real estate).

This section is potentially the most lethal. This will potentially allow ‘subjective’ factual findings as ‘objective’ fact. The effect will be to invalidate your entity structures or certain transaction(s) which yield tax savings. It is not certain how the use of such invalidation for tax purposes may be used in other courts for other purposes (such as piercing entity protections to find personal liability).

Every transaction is presumed to lack “economic substance” since the law would find a transaction to have “economic substance” ONLY IF –

- (1) the transaction changes in a meaningful way (apart from Federal tax effects) the taxpayer’s economic position, and
- (2) the taxpayer has a substantial NONTAX PURPOSE for entering into such transaction and the transaction is a reasonable means of accomplishing such purpose. If the end benefit is a reduction in income tax by a financial accounting benefit, then the accounting benefit shall not be taken into account to determine the ‘substantial nontax purpose’.

- (3) Also, a PROFIT POTENTIAL will not save you. A transaction shall not be treated as having economic substance by reason of having a potential for profit UNLESS –
- o (1) the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected, AND
 - o (2) the reasonably expected pre-tax profit from the transaction exceeds a risk-free rate of return.

This section also has special rules for financing transactions, artificial income shifting and basis adjustments and tax-indifferent parties. Call for our article: **IRS SHAKEDOWN – NEW TRAPS & TRENDS™** (by Rydstrom, Esq. LL.M.: rydstromlaw@yahoo.com).

Section 402 will add penalties for understatements of tax attributable to transactions lacking economic substance, etc. Section 6662B will impose a 40% penalty as follows:

“Sec. 6662B (a) Imposition of Penalty – If a taxpayer has a noneconomic substance transaction understatement for any taxable year, there shall be added to the tax an amount equal to 40 percent of the amount of such understatement.” [(b) 20% if adequate facts were disclosed]

Title III Entitled, Preventing Abusive Tax Shelter Transactions

Title III entitled, Preventing Abusive Tax Shelter Transactions, would enhance penalties and expand the scope to domestic transactions and entities for promoting abusive tax shelters (301) and knowingly aiding or abetting a taxpayer in understating tax liability (302).

Violation	Current Law	Bill
Promotion of Abusive Tax Shelters (IRS 6700)	50% of promoter’s gross income	Not to exceed 150% of promoter’s gross income from prohibited activity (301)
Aiding or Abetting Understatement of Tax Liability (IRS 6701)	Maximum of \$1,000 (\$10,000 corporation), penalty applies only to tax return preparer	Not to exceed 150% of aider/abettor’s gross income from prohibited activity. Penalty applies to all aiders/abettors, not just preparers (302).

Section 303 prohibits the issuance of patents designed to minimize, avoid, defer or otherwise affect tax liability. Section 304 prohibits charging a fee for tax services tied to the amount of tax savings or losses created against taxable income. Financial Institutions will be restricted from participation in abusive tax shelter activities under Section 305. 306-307 enhance the sharing of your tax information by the Treasury, SEC, Federal Bank

Regulators or PCAOB. It allows for the requirement for your CPA or tax preparer to share your tax information by Congressional subpoena. Section 308 expands the Circular 230 restrictions and standards placed upon your CPA, Attorney or promoters of tax products.

This will restrict certain professionals from advising you about saving taxes, and this section warns you that you are not allowed to use such advice to avoid taxes or penalties. This will hold us all to a higher standard when comes to tax (or asset protection) planning.

#3 - The Risks That Landlords Deny Or Do Not Understand!

Landlords must understand that to deny the potential for a problem is to help create the problem and liability. You can not put your head in the sand. This will only make you more vulnerable to attack and liability. Recall that in both the liability and tax discussions above, the law is supplying the FACTS. The law is creating “evidentiary presumptions” of “knowledge,” “control,” “wrongdoing,” and the “existence of hazards.” You can continue to deny knowledge or wrongdoing, but the trend in the law is to make your denial a non-issue to initial liability. This is a great danger. You must be aware of how dangerous this is. You must act to put your house in order now so you are protected from the new legal trends. Don’t wait for a lawsuit or tax audit, before you take action. What you do not understand, will hurt you in our new legal & tax based society. There are solutions to these risks, but the first step is to acknowledge that these risks do exist, and what they are. Second, take action to protect against all such risks.

#4 - The Opportunity That Landlords Deny Or Do Not Understand!

Landlords can win and should win. Landlords must win. We supply the housing for a great population of Americans who are busy chasing their American Dream. Landlords do a fine job. But Landlords must understand the full range of opportunities available to them so we can grow and prosper – to supply more housing needs and profit from it at the same time.

Landlords must know the law. The law says so. Recall the cases I discussed above wherein the law says that you must know all of the law related to your role as a landlord. You must know how to run a successful rental building. You must know how to benefit from the ownership and management structure of your holdings, as well as the tax benefits available. You must know how to grow and prosper. You must know how to buy, sell, or exchange your holdings in a safe, profitable and tax efficient manner. You must have contacts to industry experts on your speed dial. You must use the proper contracts for leasing and hiring employees, independent contractors, helpers, and prime or sub-contractors. What you don’t know causes you to miss out on opportunities contained in such knowledge and experience.

Where do you go to find out about these opportunities? How do you go about it? Should you join the Apartment Owners Association? Why?

Step one is to join the Apartment Owners Association. If you buy a building in an area out of this associations area, the first thing you should do, is join the local apartment association. Why? They are the best resource concerning your needs. They have the knowledge and experience concerning the issues that should concern you. They know the

issues that you should be concerned about. Therein lay opportunity. Therein lay the ability to reach for that opportunity.

You must be proactive and reactive at the same time. You must go to seminars and learn what you don't know, and learn what you need to know. Here is an example of the fast-changing laws, rules, opportunities and traps:

Moreover, if you read the magazine of the AOA and attend its seminars, you will be aware of the legal methods of deferring profits or capital gains, as opposed to the illegal ones. You now know, not to use the PAT method(s). You also know from this article, not to use a series of transactions that fail the "economic substance" test.

Here is another you just learned - that offshore trusts (even credit cards) or domestic abusive tax schemes are no longer the safe haven once thought. The trend is moving fast against all who engage in offshore or domestic tax schemes. FORE-WARNED IS FORE-ARMED. If you are engaged in such transactions or activity, call a qualified attorney to protect yourself at once.

Protections When "Facing Litigation" - Special Lesson:

Moreover, if you read the magazine of the AOA and attend its seminars, you will be aware of the legal methods of protecting your assets – even – in when facing a lawsuit or threatened with a lawsuit. A lawyer or advisor who advises or assists you in hiding your assets may be civilly and criminally liable with you for such fraudulent transfers.

However, in California there is a little know legal method that will allow you to "transfer" certain assets into a protected device, safe from attacks.

You must take-care-of-business. But it is up to you. Don't fall into the ever-changing traps and dangerous trends. Use your connection with the association to reach for the opportunities and protections landlords deserve.

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Richard Ivar Rydstrom, Esq. is a Practicing California Attorney, Professor, J.D. Law, LL.M. and may be reached by calling 949-798-6206 or at rydstromlaw@yahoo.com, www.OConnellAndRydstrom.com.