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IRS wraps up its 2021 'Dirty Dozen' scams list with warning about promoted abusive arrangements

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WASHINGTON – The Internal Revenue Service today concludes the "Dirty Dozen" list of tax scams with a warning to taxpayers to watch out for schemes peddled by tax promoters, including syndicated conservation easements, abusive micro-captive insurance arrangements and other abusive arrangements.

The IRS warns people to be on the lookout for promoters who peddle false hopes of large tax deductions from abusive arrangements. These "deals" are generally marketed by unscrupulous promoters who make false claims about their legitimacy and charge high fees to boot. These promoters frequently devise new ways to cheat the system and market them aggressively. Some taxpayers play the audit lottery hoping they don't get noticed.

To fight the evolving variety of these abusive arrangements, the IRS recently created the Office of Promoter Investigations (OPI) to focus on participants and the promoters of abusive tax avoidance transactions. OPI coordinates service-wide enforcement activities. The best defense for a taxpayer approached by a promoter is to show caution: if it sounds too good to be true, it probably is.

These aggressively marketed abusive arrangements wrap up the IRS's annual "Dirty Dozen" list and include the following:

Syndicated conservation easements
In syndicated conservation easements promoters take a provision of tax law for conservation easements and twist it through using inflated appraisals of undeveloped land and partnerships. These abusive arrangements are designed to game the system and generate inflated and unwarranted tax deductions, often by using inflated appraisals of undeveloped land and partnerships devoid of a legitimate business purpose. More information can be found here.

Abusive micro-captive arrangements
In abusive "micro-captive" structures, promoters, accountants or wealth planners persuade owners of closely held entities to participate in schemes that lack many of the attributes of insurance. For example, coverages may "insure" implausible risks, fail to match genuine business needs or duplicate the taxpayer's commercial coverages. But the "premiums" paid under these arrangements are often excessive and used to skirt tax law. Additional information can be found here. Recently, the IRS has stepped up enforcement against a variation using potentially abusive offshore captive insurance companies domiciled in Puerto Rico and elsewhere.

Potentially abusive use of the US-Malta tax treaty
Some U.S. citizens and residents are relying on an interpretation of the U.S.-Malta Income Tax Treaty (Treaty) to take the position that they may contribute appreciated property tax free to certain Maltese pension plans and that there are also no tax consequences when the plan sells the assets and distributes proceeds to the U.S. taxpayer. Ordinarily gain would be recognized upon disposition of the plan's assets and distributions of the proceeds. The IRS is evaluating the issue to determine the validity of these arrangements and whether Treaty benefits should be available in such instances and may challenge the associated tax treatment.

Improper claims of business credits
Improper claims for the research and experimentation credit generally involve failures to participate in, or substantiate, qualified research activities and/or satisfy the requirements related to qualified research expenses. To claim a research credit, taxpayers must evaluate and appropriately document their

research activities over a period of time to establish the amount of qualified research expenses paid for each qualified research activity. Taxpayers should carefully review reports or studies to ensure they accurately reflect the taxpayer's activities.

Improper monetized installment sales

Promoters find taxpayers seeking to defer the recognition of gain upon the sale of appreciated property and organize an abusive shelter through selling them monetized installment sales. These transactions occur when an intermediary purchases appreciated property from a seller in exchange for an installment note, which typically provides for payments of interest only, with principal being paid at the end of the term. In these arrangements, the seller gets the lion's share of the proceeds but improperly delays the gain recognition on the appreciated property until the final payment on the installment note, often slated for many years later.

The IRS continues to pursue actions against promoters of these schemes as well as the taxpayers who participate in them.

“We are stepping up our enforcement against abusive arrangements,” said IRS Commissioner Chuck Rettig. “Don't be lulled into these shady deals. The IRS recommends that anyone who participated in one of these abusive arrangements should consult independent counsel about coming into compliance.”

For more on tax schemes, visit IRS.gov/Dirty-Dozen.

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