Retroactive Reporting Requirements for Newly Identified Reportable Transactions Require Taxpayer Disclosure by May 1, 2017

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Internal Revenue Service (IRS) Notices 2017-10 and 2016-66 identify two new reportable transactions. Notice 2017-10 concerns transactions involving Syndicated Conservation Easements and Notice 2016-66 concerns transactions involving IRC § 831(b) Micro-Captives. Both notifications require taxpayers as well as material advisors to retroactively report certain information about such transactions. The following provides a summary of the respective notices and the liability issues each may pose to your firm. **This is not intended, however, to address all provisions that may be relevant to you and your clients. As such, CAMICO strongly encourages you to become familiar with both notices.**

Although most tax practitioners who are engaged merely to prepare tax returns do not fall into the category of "material advisor" as defined in more detail below, tax practitioners do have some potential exposure and should make every effort to warn and advise their clients regarding these newly identified reportable transactions as well as the specified due dates for filing the required IRS Forms. Additional due diligence with existing clients may be needed for those clients who indicate to you that they may have entered into one of these transactions. For example, you may need to assist them with assembling the information necessary to file IRS Form 8886, recommend corrective actions, and possibly encourage them to seek advice from tax counsel.

Consequently, warning and advising your clients as soon as possible is critical as taxpayers failing to appropriately disclose the reportable transactions to the IRS by the deadlines indicated could be subject to severe penalties. The Notices also require a separate disclosure and list maintenance requirements for persons and entities deemed to be material advisors to these transactions.

Reportable Transactions

IRC § 6111 provides that reportable transactions include several categories of transactions including listed transactions and transactions of interest. [Treas. Reg. § 1.6011-4(b)(1)]. Under § 6011 and related regulations, taxpayers must disclose their participation in listed transactions by attaching an information statement to their income tax returns. Moreover, § 6111 requires material advisors to disclose reportable transactions (e.g., identify and describe them and the claimed tax benefits), and under § 6112, material advisors must prepare and maintain lists for reportable transactions.

Taxpayers who fail to disclose their reportable transactions will be subject to penalties under IRC § 6707A, which provides for a penalty equal to the lesser of (a) 75% of the decrease in tax shown on a taxpayer's return related to the listed transaction or (b) $200,000 ($100,000 for natural persons). Additionally, taxpayers may be subject to an extended statute of limitations if they fail to disclose listed transactions.

For purposes of avoiding the accuracy-related penalties, reportable transactions need to meet the stricter "more likely than not" standard.

Syndicated Conservation Easement Transactions

Pursuant to Notice 2017-10, the IRS has identified certain "syndicated conservation easement transactions" that provide a charitable contribution deduction that significantly exceeds the amount

invested, as "listed transactions" under IRC §§ 6111 and 6112 and Treas. Reg. § 1.6011-4(b)(2). For purposes of the disclosure requirement, syndicated conservation easement transactions are defined as transactions involving one or more investors that receive promotional materials offering prospective investors in a pass-through entity the possibility of a charitable contribution deduction that equals or exceeds two and one-half times the amount of the investor's investment. Failure to disclose transactions that are the same as, or substantially similar to, the transactions described in Notice 2017-10, can have serious tax consequences. Although the listed transaction status under Notice 2017-10 does not automatically invalidate the charitable deduction, the IRS has indicated its intent to challenge the purported tax benefits from these transactions. A successful challenge of the charitable deduction by the IRS could result in a loss of the deduction as well as underpayment penalties and interest.

Taxpayer Disclosure of Syndicated Conservation Easements

Persons or entities involved in syndicated conservation easement transactions entered into after 2009 are required to disclose such transactions for each taxable year in which they were involved, provided that the period of limitations for assessment of tax has not ended before December 24, 2016. The transactions must be reported on IRS Form 8886 "Reportable Transaction Disclosure Statement."

For syndicated conservation easement transactions entered into after December 23, 2016, taxpayers are required to file Form 8886 with the Office of Tax Shelter Analysis (OTSA) **by May 1, 2017**. However, for syndicated conservation easement transactions entered into after January 1, 2010, but prior to December 23, 2016, taxpayers are required to file IRS Form 8886 within **180 calendar days of the Notice** (**by June 21, 2017**). Failure to disclose transactions that are the same as, or substantially similar to, the transactions described in Notice 2017-10 can have serious tax consequences.

Taxpayers who have already filed tax returns with these transactions should take appropriate corrective action to ensure that the proper disclosure is made. Refer to Notice 2017-10 for further information regarding the disclosure requirements for taxpayers and material advisors involved in such listed transactions.

Material Advisor Disclosure of Syndicated Conservation Easement

Notice 2017-10 indicates that "material advisors" (including appraisers) who make a tax statement on or after January 1, 2010, with respect to syndicated conservation easement transactions, have disclosure and list maintenance obligations under IRC §§ 6111 and 6112. The statutes require material advisors to maintain lists identifying each person with respect to whom the advisors acted as material advisors regarding reportable transactions.

IRC § 6111(b) and Treas. Reg. § 301.6111-3 define a "material advisor" for listed transactions as any person who:

1) provides material assistance in organizing, managing, promoting, selling, or carrying out a listed transaction and who

2) receives gross income for providing such assistance of (i) at least $10,000 where the tax benefits benefited a natural person or (ii) $25,000 in other instances.

For example, an investment advisor who sold investments in syndicated conservation easement

transactions may be deemed a "material advisor" and subject to specific disclosure and maintenance obligations.

Per Notice 2017-10, material advisors are required to file a disclosure statement with the OTSA **by May 1, 2017**. Treas. Reg. § 301.6111-3(d) requires that material advisors complete this disclosure on Form 8918, the "Material Advisor Disclosure Statement." The Form requires the following:

1) Information identifying and describing the listed transaction
2) Information describing any potential tax benefits expected to result from the transaction
3) Other information requested by the IRS

Additionally, IRC § 6112 generally requires that material advisors maintain a list identifying each person whom the advisor advised with respect to the listed transaction. Material advisors are required to make that list available for inspection upon written request by the IRS.

Micro-Captive Transactions

Pursuant to Notice 2016-66, the IRS has identified "micro-captive transactions" as "transactions of interest" under Treas. Reg. § 1.6011–4(b)(6) and IRC §§ 6111 and 6112. An abusive micro-captive transaction is a type of transaction in which a taxpayer attempts to evade taxation by entering into contracts with a related company that is treated as a captive insurance company, using inflated premiums, and taking advantage of IRC § 831(b)'s election to only tax small insurance companies on their investment income.

Generally, for purposes of the disclosure requirement, micro-captive transactions are defined as transactions where a taxpayer enters into a purported insurance contract with a captive insurance company ("Captive"), or a purported reinsurance contract with a Captive through an intermediary insurance company, and where a Captive is at least 20% owned by the taxpayer and/or related parties. In addition, micro-captive transactions have one or both of the following characteristics:

1) The Captive's liabilities for insured losses and claim administration expenses are less than 70% of the Captive's earned premiums less paid policyholder dividends, or
2) The Captive made available through a guarantee, a loan, or other transfer of Captive's capital, any portion of payments received under contracts to the taxpayer or its owners.

The taxpayer, an "insured" entity under the contract, claims ordinary deductions for purported insurance or reinsurance premiums while a Captive elects under IRC § 831(b) to be taxed only on investment income. The Captive then excludes the payments directly or indirectly received under the contracts from its taxable income.

Taxpayer Disclosure of 831(b) Micro-Captive

Persons or entities involved in such transactions entered into on or after November 2, 2006**, must disclose them to the IRS by May 1, 2017** and taxpayers who have already filed tax returns with these transactions should take appropriate corrective action to ensure that the proper disclosure is made. For further information regarding definitions and disclosure requirements for taxpayers and material advisors, refer to Notice 2016-66. Failure to disclose transactions that are the same as, or substantially

similar to, the transactions described in Notice 2016-66 can have serious tax consequences.

Material Advisor Disclosure of 831(b) Micro-Captive

Notice 2016-66 indicates that "material advisors" who make a tax statement on or after November 2, 2016, with respect to Section 831(b) micro-captive transactions, have disclosure and list maintenance obligations under IRC §§ 6111 and 6112 identical to the requirements for transactions involving syndicated conservation easements.

For example, an insurance management firm that structures, markets or assists in implementing a micro-captive insurance strategy may be deemed a "material advisor" and subject to the required disclosure and record maintenance obligations. According to Notice 2017-8, a material advisor described in Notice 2016-66 must file the required disclosure statement with the OTSA **by May 1, 2017**.

Risk Management Advice

CAMICO strongly recommends that policyholders send a letter to their clients as soon as possible informing them of the retroactive reporting requirements. The communication should advise clients of each of the IRS's recent Notices, the requirements of each, and the potential tax, penalty, and interest implications of not complying. The letter should also include a strong "call to action" message for those clients who have participated in either Syndicated Conservation Easements after 2009 or Micro-Captive transactions on or after November 2, 2006, to inform you of those transactions immediately. CAMICO recommends you also provide them with a drop-dead date as well so that you can provide your firm with adequate time to be able assist impacted clients appropriately. For defensive documentation purposes, CAMICO recommends a list be maintained and retained detailing to whom this letter was sent. **CAMICO provides sample letter(s) to CAMICO policyholders on the CAMICO Members-Only Site under Knowledge Tree –> Reference Library –> Alert Documents –> 2017 –> New Reportable Transactions.**

If a reportable transaction impacts a client's current year income tax return (e.g., a charitable contribution carryforward), the tax preparer should obtain the client's written acknowledgment regarding whether he/she (a) has been apprised of the relevant IRS Notice(s) and their implications, and (b) chooses to disclose the reportable transaction(s) and amend the tax return as may be required. **CAMICO provides sample informed consent letters to CAMICO policyholders on the CAMICO Members-Only Site under Knowledge Tree –> Reference Library –> Alert Documents –> 2017 –> New Reportable Transactions.** CAMICO recommends that tax practitioners disengage from clients that refuse to sign the requested informed consent.

Additional information:

- Notice 2017-10
- Notice 2016-66
- Notice 2017-8