

In the
United States Court of Appeals
For the Second Circuit

August Term, 2014
Nos. 13-4526-ag (L), 13-4527-ag (CON)

ROBERT L. PROSSER, III, MARY C. PROSSER, MCGEEHEE FAMILY
CLINIC, P.A.,
Petitioners-Appellants,

v.

Appeals from the United States Tax Court, Nos. 15646-08, 15647-08.

ARGUED: OCTOBER 8, 2014
DECIDED: FEBRUARY 4, 2015

Before: JACOBS, SACK, and DRONEY, *Circuit Judges*.

1 Appeal from orders of the United States Tax Court upholding
2 accuracy-related penalties against Petitioners under § 6662A of the
3 Internal Revenue Code for understatements attributable to their
4 involvement in the Benistar 419 Plan and Trust. The Tax Court held
5 that the Benistar Plan was substantially similar to the listed tax-
6 avoidance transaction described by the Internal Revenue Service in
7 Notice 95-34. The Tax Court also held that Petitioners had adequate
8 notice of the penalties under § 6662A and that the increased penalty
9 rate under § 6662A(c) applied. We **AFFIRM**.

11
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13 *brief*), Wormser, Kiely, Galef & Jacobs
14 LLP, New York, NY, *for Petitioners-*
15 *Appellants*.

16
17 RANDOLPH L. HUTTER (Tamara W.
18 Ashford, Acting Assistant Attorney
19 General; Thomas J. Clark, *on the*
20 *brief*), Tax Division, Department of
21 Justice, Washington, D.C., *for*
22 *Respondent-Appellee*.

23
24
25 DRONEY, *Circuit Judge*:

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27 Robert and Mary Prosser (“the Prossers”) and the McGehee
28 Family Clinic (“the Clinic,” and collectively “Petitioners”) filed
29 petitions for redetermination in the United States Tax Court

1 challenging the Commissioner of Internal Revenue's
2 ("Commissioner") determination of tax deficiencies and assessment
3 of penalties against them under § 6662A of the Internal Revenue
4 Code, 26 U.S.C. § 1 *et seq.* ("I.R.C."). The Commissioner had
5 determined that Petitioners were deficient based on a contribution
6 by the Clinic to a multiple-employer welfare benefit plan, the
7 Benistar 419 Plan and Trust ("the Benistar Plan" or "the Plan"),
8 which the Commissioner concluded was not an "ordinary and
9 necessary" business expense within the meaning of I.R.C. § 162(a).
10 The Commissioner also determined that the Benistar Plan was
11 "substantially similar" to the listed tax-avoidance transaction
12 described by the Internal Revenue Service ("IRS") in I.R.S. Notice 95-
13 34, 1995-1 C.B. 309 ("Notice 95-34").¹ Because the Prossers had an
14 understatement of income on their joint personal return attributable

¹ Notice 95-34 is one of thirty-four currently recognized tax-avoidance transactions identified by the IRS in formal guidance pursuant to I.R.C. § 6707A(c)(2). *See* Recognized Abusive and Listed Transactions, IRS, <http://www.irs.gov/Businesses/Corporations/Listed-Transactions---LB&I-Tier-I-Issues> (last visited February 3, 2015).

1 to the Clinic's contribution to the Benistar Plan, the Commissioner
2 assessed an accuracy-related penalty against them under I.R.C.
3 § 6662A, as well as an increased accuracy-related penalty against the
4 Clinic.

5 Petitioners and other participants in the Benistar Plan who
6 had been assessed similar deficiencies by the Commissioner agreed
7 to be bound by the final resolution of a petition for redetermination
8 in *Curcio v. Commissioner*, 99 T.C.M. (CCH) 1478, 2010 WL 2134321
9 (2010). In *Curcio v. Commissioner*, 689 F.3d 217 (2d Cir. 2012), this
10 Court affirmed the Tax Court's decision that employer contributions
11 to the Benistar Plan were not "ordinary and necessary" business
12 expenses within the meaning of the I.R.C. *Id.* at 225. As a result, the
13 Tax Court in these proceedings upheld the Commissioner's
14 determination of tax deficiencies against Petitioners based on the
15 Clinic's contribution to the Benistar Plan. The only issue in this

1 consolidated appeal² is whether the Tax Court was justified in
2 upholding the Commissioner's imposition of additional accuracy-
3 related penalties under I.R.C. § 6662A, an issue not resolved in the
4 *Curcio* proceedings.

5 For the reasons set forth below, we hold that the Benistar Plan
6 is substantially similar to the listed tax-avoidance transaction
7 identified by the IRS in Notice 95-34. We therefore uphold the
8 Commissioner's assessment of accuracy-related penalties against the
9 Prossers and the Clinic under I.R.C. § 6662A. We also hold that
10 Petitioners had adequate notice of the potential for penalties under
11 § 6662A and that the increased penalty rate under § 6662A(c) applies
12 to the Clinic. Accordingly, we **AFFIRM** the decisions of the Tax
13 Court.

² The Prossers and the Clinic filed separate Tax Court petitions, which were consolidated before the Tax Court. Separate notices of appeal were subsequently filed.

1 limits for contributions made to “any welfare benefit fund which is
2 part of a 10-or-more employer plan.” I.R.C. § 419A(f)(6)(A).

3 Employers that were enrolled in the Benistar Plan contributed
4 to a trust account operated by the Plan that was used to pay
5 premiums on life insurance policies for certain employees, which
6 included “one or more key Executives on a selective basis.” *Curcio*,
7 2010 WL 2134321, at *2, *5. However, the individual employee
8 participants selected the insurance policies. Employers could also
9 contribute additional amounts above the amount the Benistar Plan
10 required to keep the underlying insurance policy active. *Id.* at *5.
11 These additional contributions “remain[ed] in the trust account,”
12 were “not used to make additional payments on the underlying
13 insurance policy,” and would have substantial cash value based on
14 the portion of the contributions not necessary for coverage. *Id.*
15 Claiming that the Plan fell within § 419A(f)(6)’s exemption from
16 deduction limits, the promoters of the Benistar Plan informed

1 participating employers that tax deductions for these contributions,
2 which the plan separately recorded for each employer, were
3 “[v]irtually [u]nlimited.” *Id.*

4 Employers could terminate their participation in the Benistar
5 Plan at any time. *Id.* at *6. From mid-2002 to mid-2005, the Benistar
6 Plan distributed the underlying policies of terminated accounts to
7 the insured employees for ten percent of the cash surrender value of
8 the policy. *Id.* Beginning in mid-2005, the Benistar Plan began to
9 charge covered employees the entire fair market value of their
10 underlying policy when the employer terminated participation. *Id.*
11 at *7. However, the Benistar Plan did not require this payment
12 immediately, but rather allowed the insured employee to borrow
13 from the trust the cost of the purchase, providing as collateral the
14 insurance policy itself. *Id.* In lieu of charging interest on the loan,
15 the Benistar Plan charged an insured employee ten percent of the
16 net surrender value of the policy, which had to be prepaid at the

1 time the insured employee requested to withdraw the underlying
2 policy. *Id.*

3 To summarize, the Benistar Plan allowed employers to make
4 tax-free contributions for life insurance policies for certain “key”
5 employees, and allowed additional contributions—also tax-free—
6 above what was required to cover the potential death benefits of the
7 policies. Those employees could then “retrieve the value in those
8 policies with minimal expense” after participation in the Benistar
9 Plan was terminated. *Id.* at *20.

10 In *Curcio*, the Tax Court held that contributions to the Benistar
11 Plan by certain other businesses—a construction company, a
12 mortgage broker, and automobile dealerships—were not “ordinary
13 and necessary” business expenses eligible for deduction under I.R.C.
14 § 162(a). *Id.* The Tax Court explained that taxpayers “used [the]
15 Benistar Plan to funnel pretax business profits into cash-laden life
16 insurance policies over which they retained effective control. As a

1 result, contributions to [the] Benistar Plan are more properly viewed
2 as constructive dividends to petitioners and are not ordinary and
3 necessary business expenses under [§] 162(a)." *Id.* at *13. According
4 to the Tax Court, the Benistar Plan was "a thinly disguised vehicle
5 for unlimited tax-deductible investments." *Id.* at *20.

6 This Court affirmed the Tax Court's decision in *Curcio*,
7 explaining that "contributions [to the Benistar Plan] were made
8 solely for the personal benefit of petitioners," and "were a
9 mechanism by which petitioners could divert company profits, tax-
10 free, to themselves, under the guise of cash-laden insurance policies
11 that were purportedly for the benefit of the businesses, but were
12 actually for petitioners' personal gain." *Curcio*, 689 F.3d at 226. As a
13 result, we held that the Tax Court was correct in concluding that
14 contributions to the Benistar Plan were not deductible by those
15 businesses, and that the employees in whose name these
16 contributions were made should have listed the contributions as

1 personal income. *Id.* Penalties under I.R.C. § 6662A, however, were
2 not at issue in *Curcio* because § 6662A penalties only applied to tax
3 returns filed after October 22, 2004, *see* American Jobs Creation Act
4 of 2004, Pub. L. No. 108-357, § 812(f), 118 Stat. 1418, 1580, and *Curcio*
5 involved improper deductions in returns filed prior to October 2004,
6 *see Curcio*, 689 F.3d at 220-22.³

7 **II. Accuracy-Related Penalties Against Petitioners Under**
8 **I.R.C. § 6662A**

9 *A. Factual Background*⁴

10 Dr. Robert Prosser, a family medicine physician, was the sole
11 owner and an employee of the McGehee Family Clinic, a C

³ In *Curcio*, we upheld penalties against the petitioners under I.R.C. § 6662(b)(1)-(2), but those provisions require a determination of negligence. *See Curcio*, 689 F.3d at 229. Section 6662A, however, was enacted in 2004 and imposes penalties on tax-avoidance arrangements similar to “listed transaction[s]” as described in the I.R.C. Only the penalties imposed on the Clinic and the Prossers under § 6662A are at issue here.

⁴ While most of the parties’ stipulation of facts involved *Curcio*’s record, the parties also stipulated in the Tax Court to factual matters related to the Prossers’ and the Clinic’s involvement in the Benistar Plan, as described below.

1 corporation⁵ and family medicine practice in McGehee, Arkansas.
2 The Clinic enrolled in the Benistar Plan in May 2001 and first
3 claimed a deduction for a contribution to the Plan on the tax return
4 it filed in 2002. The Clinic then made a \$50,000 contribution to the
5 Benistar Plan during its 2004 tax year on behalf of Dr. Prosser, and
6 claimed a \$45,833 deduction for that contribution.⁶ Although IRS
7 Form 8886, a “Reportable Transaction Disclosure Statement,” was
8 available to the Clinic, the Clinic did not file any document
9 disclosing its involvement in the Benistar Plan with its tax return for
10 the 2004 tax year. The Prossers did not include the amount of the
11 Clinic’s contribution to the Benistar Plan on Dr. Prosser’s behalf as
12 income in their joint personal tax return, which they filed in 2005 for
13 the tax year ending December 31, 2004.

⁵ A C corporation is a separate legal entity for tax purposes, which is governed by subchapter C of the I.R.C. and functions as a conduit for attributing gains and losses to its owner. *See Sidell v. Comm’r*, 225 F.3d 103, 105 (2d Cir. 2000).

⁶ We refer to the Clinic’s tax year ending March 31, 2005 as its 2004 tax year. Only the contribution during the 2004 tax year is at issue here. It is undisputed that the actual cost of term life insurance coverage for Dr. Prosser for that year was much less than the amount of the deduction taken by the Clinic.

1 On March 21, 2008, the Commissioner sent Notices of
2 Deficiency to the Clinic for deducting its contribution to the Benistar
3 Plan during its 2004 tax year, and to the Prossers for failing to report
4 the Clinic’s contribution as taxable income. The Commissioner also
5 imposed accuracy-related penalties against Petitioners under I.R.C.
6 § 6662A, which establishes a twenty-percent penalty for “reportable
7 transaction understatement[s]” attributable to a “listed” tax-
8 avoidance transaction or a transaction “substantially similar”
9 thereto. I.R.C. §§ 6662A(a), (b)(2)(A); 6707A(c)(2). The penalty rate
10 is increased to thirty percent under § 6662A(c) for understatements
11 that do not meet the disclosure requirements of § 6664(d)(2)(A).⁷
12 The Commissioner imposed penalties at the rate of twenty percent
13 in the amount of \$3,500 against the Prossers, and at the increased

⁷ Section 6664(d)(2)(A) was redesignated as § 6664(d)(3)(A) in 2010. *See* Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409(c)(2)(A), 124 Stat 1029, 1069. Although it does not appear Congress updated § 6662A(c) to reflect the redesignation of § 6664(d)(2)(A) to § 6664(d)(3)(A), the redesignation was effective beginning March 30, 2010, well after the tax years at issue and the petitions were filed in this case. All subsequent citations to § 6664(d)(2)(A) in this opinion refer to § 6664(d)(2)(A) in effect prior to its 2010 redesignation.

1 rate of thirty percent in the amount of \$4,812.47 against the Clinic.

2 *B. Procedural History*

3 On June 25, 2008, Petitioners filed petitions in the Tax Court
4 for redetermination of the deficiencies assessed by the
5 Commissioner in connection with their involvement in the Benistar
6 Plan. Petitioners also challenged the Commissioner's assessment of
7 § 6662A accuracy-related penalties against them.

8 On the question of whether contributions to the Benistar Plan
9 were "ordinary and necessary" business expenses eligible for
10 deduction, Petitioners stipulated that they would be bound by the
11 outcome of *Curcio*. This Court in *Curcio* affirmed the Tax Court's
12 conclusion that contributions to the Benistar Plan were not
13 "ordinary and necessary" business expenses within the meaning of
14 the I.R.C. *Curcio*, 689 F.3d at 225. After the *Curcio* decision, the Tax
15 Court in these proceedings upheld the Commissioner's
16 determinations of deficiency and imposition of I.R.C. § 6662A

1 penalties against Petitioners. The only issue appealed from the Tax
2 Court's decision was whether the Commissioner properly imposed
3 penalties against Petitioners under § 6662A for understatements
4 attributable to a listed tax-avoidance transaction.

5 In the Tax Court, the Commissioner argued that the Benistar
6 Plan was substantially similar to the tax-avoidance transaction
7 identified by the IRS in Notice 95-34, which describes certain welfare
8 benefit plans that improperly claim to satisfy the multiple-employer
9 exemption from deduction limits. I.R.S. Notice 95-34, 1995-1 C.B.
10 309. Notice 95-34 explains which plans fail to qualify for the
11 exemption under I.R.C. § 419A(f)(6) and why contributions to these
12 plans are not ordinary and necessary business expenses eligible for
13 deduction. *Id.*

14 Relying on the record in *Curcio*, the Tax Court issued a
15 Memorandum Opinion finding that the Benistar Plan “obtains
16 similar types of tax benefits and is factually similar to the listed

1 transaction in Notice 95-34.” *McGehee Family Clinic, P.A.*, 2010 WL
2 3583386, at *4. The Tax Court explained that, like the arrangements
3 described in Notice 95-34, the Benistar Plan “claimed to satisfy the
4 requirements for the 10-or-more-employers-plan exemption under
5 [§] 419A(f)(6) and offered life insurance.” *Id.* at *4. The “benefits of
6 enrollment listed in the packet sent to newly enrolled employers
7 included ‘virtually unlimited deductions.’” *Id.* at *3. The life
8 insurance policies administered by the Plan “required large
9 contributions relative to the cost of the amount of term insurance
10 that would be required to provide the death benefits under the
11 arrangement.” *Id.* at *4. Relatedly, the Plan “permit[ted] employers
12 to make contributions larger than those necessary to maintain the
13 policy,” and “the contribution [was] used only for the policy to
14 which it [was] allocated.” *Id.*

15 The Tax Court also explained that Benistar Plan participants
16 “had the right to receive the value reflected in the underlying

1 insurance policies purchased by [the] Benistar Plan despite the fact
2 that the payment of benefits by [the] Benistar Plan seemed to be
3 contingent upon an unanticipated event.” *Id.* There was “no reason
4 ever to forfeit a policy to the plan” and the evidence showed that
5 “most participants in [the] Benistar Plan and their beneficiaries
6 receive their benefits despite the alleged contingency of those
7 benefits on the occurrence of an unanticipated event.” *Id.* Although
8 the Tax Court noted that the Benistar Plan did not reduce benefits if
9 the assets derived from an employer’s contributions were
10 insufficient to fund the benefits, as some of the plans described in
11 Notice 95-34 do, the Benistar Plan did “maintain separate accounting
12 of the assets attributable to contributions made by each subscribing
13 employer in an internal spreadsheet.” *Id.*

14 Based on this analysis, the Tax Court found that the Benistar
15 Plan was expected to obtain the same type of tax benefits as, and
16 was factually similar to, the arrangements described in Notice 95-34.

1 *Id.* Thus, the Tax Court concluded that the Benistar Plan was
2 “substantially similar” to a listed tax-avoidance transaction and
3 upheld the Commissioner’s assessment of § 6662A penalties against
4 Petitioners. The Tax Court also concluded that the Clinic “did not
5 disclose its participation in [the] Benistar Plan in accordance with
6 [§] 6664(d)(2)(A),” and consequently was subject to the increased
7 thirty-percent penalty rate under § 6662A(c). *Id.* at *5.

8 After this Court issued its *Curcio* decision, the Tax Court
9 entered an Order and Decision on September 3, 2013, upholding the
10 Commissioner’s deficiency determinations and assessment of
11 penalties against Petitioners based on its Memorandum Opinion.
12 Petitioners appealed on November 29, 2013, and the appeals were
13 consolidated on January 24, 2014.

14 DISCUSSION

15 I. Standard of Review

16 This Court reviews the Tax Court’s “legal conclusions *de novo*

1 and its factual findings for clear error.” *Callaway v. Comm’r*, 231 F.3d
2 106, 115 (2d Cir. 2000). Mixed questions of law and fact “are
3 reviewed *de novo*, to the extent that the alleged error is in the
4 misunderstanding of a legal standard.” *Diebold Found., Inc. v.*
5 *Comm’r*, 736 F.3d 172, 183 (2d Cir. 2013); *see* I.R.C. § 7482(a)(1) (“The
6 United States Courts of Appeals . . . shall . . . review the decisions of
7 the Tax Court . . . in the same manner and to the same extent as
8 decisions of the district courts in civil actions tried without a jury
9 . . .”).

10 Whether the Benistar Plan is “substantially similar” to the tax-
11 avoidance transaction identified in Notice 95-34, and whether the
12 Clinic “adequately disclosed” the relevant facts concerning its
13 contribution to the Benistar Plan, are mixed questions of law and
14 fact. They are questions of law to the extent this Court must review
15 the Tax Court’s interpretation of the legal standard. They are
16 questions of fact to the extent this Court must review the Tax

1 Court's findings of historical fact. Many of these facts are not in
2 dispute as the parties stipulated to various aspects of Petitioners'
3 involvement in the Benistar Plan and to *Curcio's* record regarding
4 the nature of the Benistar Plan. Nevertheless, application of the facts
5 to the legal standard in this case involves mixed questions of law
6 and fact, which this Court reviews *de novo*. *Diebold Found.*, 736 F.3d
7 at 183.

8 **II. Accuracy-Related Penalties Under I.R.C. § 6662A**

9 I.R.C. § 6662A provides: "If a taxpayer has a reportable
10 transaction understatement for any taxable year, there shall be
11 added to the tax an amount equal to 20 percent of the amount of
12 such understatement." I.R.C. § 6662A(a). A "reportable transaction
13 understatement" includes any understatement attributable to a
14 "listed" transaction. *Id.* § 6662A(b)(2)(A). A listed transaction, in
15 turn, is a transaction that "is the same as, or substantially similar to,
16 a transaction specifically identified by the Secretary [of the Treasury]

1 as a tax avoidance transaction.” *Id.* § 6707A(c)(2). Finally, IRS
2 regulations define a transaction to be “substantially similar to” a
3 listed tax-avoidance transaction if it is “expected to obtain the same
4 or similar types of tax consequences and . . . is either factually
5 similar [to] or based on the same or similar tax strategy” as the listed
6 tax-avoidance transaction.⁸ Treas. Reg. § 1.6011-4(c)(4) (as amended
7 in 2010); *see* Tax Shelter Regulations, 68 Fed. Reg. 10,161, 10,167
8 (Mar. 4, 2003).

9 Thus, the question before us is whether the Benistar Plan was
10 expected to obtain similar tax consequences as, and is either
11 factually similar to or based on a similar tax strategy as, the tax-
12 avoidance arrangements described by the IRS in Notice 95-34. For

⁸ Petitioners do not challenge the IRS’s authority to promulgate a regulation interpreting the term “substantially similar to” as used in I.R.C. § 6707A(c)(2), nor do they argue that the IRS’s interpretation of the I.R.C. is not entitled to deference. We simply note that “[b]ecause Congress has delegated to the Commissioner the power to promulgate ‘all needful rules and regulations for the enforcement of [the Internal Revenue Code],’ 26 U.S.C. § 7805(a), we must defer to his regulatory interpretations of the Code so long as they are reasonable.” *McNamee v. Dep’t of the Treasury*, 488 F.3d 100, 106 (2d Cir. 2007) (quoting *Cottage Sav. Ass’n v. Comm’r*, 499 U.S. 554, 560-61 (1991)).

1 the reasons set forth below, we hold that the Benistar Plan is
2 substantially similar to the arrangements described in Notice 95-34.
3 We therefore uphold the Commissioner's accuracy-related penalties
4 against Petitioners under § 6662A.

5 *A. The Tax-Avoidance Transaction Identified in Notice*
6 *95-34*

7 The IRS published Notice 95-34 as formal guidance in 1995
8 and classified the arrangements described therein as "listed" tax-
9 avoidance transactions in 2000.⁹ See I.R.S. Notice 95-34, 1995-1 C.B.
10 309; I.R.S. Notice 2000-15, 2000-1 C.B. 826. Notice 95-34 describes
11 welfare benefit trusts that ostensibly "provide benefits such as life
12 insurance, disability, and severance pay benefits" to employees.
13 I.R.S. Notice 95-34, 1995-1 C.B. 309. The trusts claim to be multiple-

⁹ The IRS originally published Notice 95-34 after certain "Voluntary Employee Beneficiary Associations" plans came to its attention. The IRS published Notice 95-34 to make clear that it did not consider these plans to comply with the tax code, and that deductions under such tax-avoidance plans would be disallowed. See generally *Cetel v. Kirwan Fin. Grp., Inc.*, 460 F.3d 494, 502 (3d Cir. 2006). It was not until 2004, however, that Congress created additional accuracy-related penalties under § 6662A for improper deductions attributable to listed tax-avoidance transactions, such as the transaction identified in Notice 95-34. See American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004).

1 employer welfare benefit plans that qualify for I.R.C. § 419A(f)(6)'s
2 exemption from limits on the amount of plan contributions eligible
3 for deduction. *Id.* However, these plans “require large employer
4 contributions relative to the cost of the amount of term insurance
5 that would be required to provide the death benefits under the
6 arrangement.” *Id.* The plans also “often maintain separate
7 accounting of the assets attributable to the contributions made by
8 each subscribing employer,” which “pursuant to formal or informal
9 arrangements or practices . . . insulates the employer to a significant
10 extent from the experience of other subscribing employers.” *Id.*
11 Although “benefits may appear to be contingent on the occurrence
12 of unanticipated future events, in reality, most participants and their
13 beneficiaries will receive their benefits” because trust administrators
14 can “cash[] in or withdraw[] the cash value of the insurance
15 policies.” *Id.*

16 Notice 95-34 concludes that these arrangements do not satisfy

1 the requirements for § 419A(f)(6)'s exemption "for any one of several
2 reasons, including the following": (1) the arrangements may be
3 providing deferred compensation; (2) the arrangements may be a
4 collection of separate plans rather than a single multiple-employer
5 plan; (3) the arrangements may be "experience rated" with respect to
6 individual employers because the trusts maintain separate
7 accounting, and employers expect that their contributions will
8 benefit only their employees; and (4) contributions under the
9 arrangements may represent prepaid expenses that are
10 nondeductible. *Id.*

11 *B. The Benistar Plan's Substantial Similarity to the*
12 *Transaction Identified in Notice 95-34*

13 As mentioned, we base our substantial similarity analysis on
14 *Curcio's* record, supplemented by the additional facts relevant to the
15 Clinic and the Prossers. That record reflects the following factual
16 and tax strategy similarities between the Benistar Plan and the
17 transaction identified in Notice 95-34:

1 1. The Benistar Plan claimed to satisfy the requirements for
2 the multiple-employer exemption under I.R.C. § 419A(f)(6), and the
3 purported benefits of enrollment included “Virtually Unlimited
4 Deductions.” *See Curcio*, 2010 WL 2134321, at *5.

5 2. The Benistar Plan offered life insurance policies that
6 allowed large contributions relative to the cost of the amount of term
7 insurance required to provide the corresponding death benefits
8 under the arrangement. *See id.* at *21.

9 3. Benistar Plan participants acted as though they personally
10 owned the underlying policies, and the Benistar Plan was merely a
11 conduit to the policies rather than the actual insurer. *See id.* at *18.

12 4. The Benistar Plan maintained separate accounting of each
13 employer’s assets based on that employer’s contributions, which
14 helped insulate contributions and benefits from the participation of
15 other subscribing employers. *See id.* Correspondingly, contributions
16 were used only for the policies to which they were allocated. *See id.*

1 at *5.

2 5. Benistar Plan participants had the right to receive—and
3 most participants did in fact receive—the value reflected in the
4 underlying insurance policies with minimal expense by terminating
5 participation in the Plan, despite payment of benefits supposedly
6 being contingent upon unanticipated events. *See id.* at *13, *20.
7 Daniel Carpenter, the creator of the Benistar Plan, acknowledged
8 that there was no reason to ever forfeit an underlying insurance
9 policy so long as Benistar Plan participants were willing to abide by
10 the Plan’s distribution policies. *See id.* at *20.

11 Based on these factual similarities and the common tax-
12 avoidance strategy of allowing (i) large tax-free contributions far
13 exceeding the cost of maintaining the underlying insurance
14 coverage, (ii) individual funding and control of the policies, and (iii)
15 retrieval of the policies with minimal expense, we hold that the
16 Benistar Plan is substantially similar to the listed tax-avoidance

1 transaction identified in Notice 95-34. The Commissioner therefore
2 properly assessed § 6662A penalties against Petitioners for
3 understatements attributable to the Clinic's Benistar Plan
4 contribution.¹⁰ We need not identify whether any one factor in
5 particular is necessary for determining that a transaction is
6 substantially similar to a listed tax-avoidance transaction. Rather, it
7 is sufficient under the I.R.C. and IRS regulations that the Benistar
8 Plan replicates the primary mechanics of and shares a common tax-
9 avoidance strategy with the transaction identified in Notice 95-34.

10 Petitioners principally argue that to be substantially similar to
11 a listed transaction, the Benistar Plan must fail to satisfy
12 § 419A(f)(6)'s exemption requirements for all four of the reasons
13 explained in Notice 95-34. However, Notice 95-34 provides that

¹⁰ As we have noted in prior decisions, one might also consider "whether some level of deference ought to be given to the Commissioner's interpretation of the Treasury's own regulations" in analyzing whether the Benistar Plan is substantially similar to the transaction identified in Notice 95-34. *Robinson Knife Mfg. Co. v. Comm'r*, 600 F.3d 121, 134 n.11 (2d Cir. 2010) (citing *Auer v. Robbins*, 519 U.S. 452, 461 (1997)). However, "we need not decide whether *Auer* deference applies here" because "the Commissioner has not argued *Auer* deference," and "even if we were to apply *Auer*, we would not reach a different result." *Id.*

1 “[i]n general, these arrangements and other similar arrangements do
2 not satisfy the requirements of the [§] 419A(f)(6) exemption and do
3 not provide the tax deductions claimed by their promoters *for any*
4 *one of several reasons.*” I.R.S. Notice 95-34, 1995-1 C.B. 309 (emphases
5 added). By using “in general” and “for any one of several reasons,”
6 Notice 95-34 clearly indicates it is not necessary that an arrangement
7 fail to satisfy § 419A(f)(6)’s exemption requirements for every one of
8 the reasons provided. Indeed, Notice 95-34 itself identifies a fifth
9 reason: contributions to such plans may not qualify as “ordinary and
10 necessary business expenses of the taxpayer [under I.R.C. § 162(a)].”
11 *Id.* That is the very reason contributions to the Benistar Plan are not
12 deductible. *See Curcio*, 689 F.3d at 226 (describing the Benistar Plan
13 as “a mechanism by which [owners of participating businesses]
14 could divert company profits, tax-free, to themselves, under the
15 guise of cash-laden insurance policies”). Nor do the reasons
16 provided constitute an exhaustive list as to why plans like these do

1 not satisfy the requirements for § 419A(f)(6)'s exemption.

2 At any rate, the record shows that the Benistar Plan is, like the
3 transaction described in Notice 95-34 in both its earlier paragraphs
4 and in reason three, "experience rated" in that the Plan maintained,
5 "formally or informally, separate accounting for each employer and
6 the employers ha[d] reason to expect that, at least for the most part,
7 their contributions [would] benefit only their own employees."
8 I.R.S. Notice 95-34, 1995-1 C.B. 309. The record establishes that the
9 Benistar Plan maintained separate accounting for each participating
10 employer, and that contributions were used only for the policies to
11 which they were allocated. *Curcio*, 2010 WL 2134321, at *5, *18.

12 We also reject Petitioners' argument that the substantial
13 similarity analysis cannot rely on the paragraphs in Notice 95-34 that
14 precede the four listed "reasons" contained in the Notice.
15 Petitioners describe these preceding paragraphs as "introductory"
16 and as a "preamble." However, Petitioners misrepresent the nature

1 of these paragraphs and their relationship to the “reasons” that
2 follow them. These paragraphs describe the particular factual
3 characteristics of the typical tax-avoidance transaction considered by
4 Notice 95-34 and include a substantial description of their common
5 elements. By describing the factual characteristics of these schemes,
6 these paragraphs are especially relevant to whether a plan is
7 substantially similar to the arrangements identified in Notice 95-34.
8 The “reasons” that follow merely explain why contributions to the
9 plans described in the preceding paragraphs do not constitute
10 “ordinary and necessary” expenses under I.R.C. § 162(a), and why
11 the plans do not qualify as multiple-employer welfare benefit trusts
12 under § 419A(f)(6).

13 **III. Increased Penalty Rate Under § 6662A(c)**

14 I.R.C. § 6662A generally imposes accuracy-related penalties at
15 a rate of twenty percent of the amount of the understatement
16 attributable to the listed transaction. I.R.C. § 6662A(a). However,

1 § 6662A increases the penalty rate to thirty percent when disclosure
2 requirements under § 6664(d)(2)(A)¹¹ are not satisfied. *Id.*
3 § 6662A(c). Section 6664(d)(2)(A) requires “adequate[] disclosure” of
4 “the relevant facts affecting the tax treatment” of the transaction in
5 accordance with IRS regulations. *Id.* § 6664(d)(2)(A). These
6 disclosures are intended to provide the IRS with information needed
7 to evaluate potentially abusive transactions. *See* Modification of Tax
8 Shelter Rules III, 67 Fed. Reg. 41,324, 41,325 (June 18, 2002).

9 A taxpayer has participated in a listed transaction and must
10 therefore disclose the relevant facts affecting the tax treatment of
11 that transaction “if the taxpayer’s tax return reflects tax
12 consequences or a tax strategy described in the [IRS’s] published
13 guidance” or “if the taxpayer knows or has reason to know that the
14 taxpayer’s tax benefits are derived directly or indirectly from tax
15 consequences or a tax strategy described in published guidance.”

¹¹ As discussed previously, § 6664(d)(2)(A) was redesignated as § 6664(d)(3)(A) in 2010 after the tax years at issue in this case.

1 Treas. Reg. § 1.6011-4(c)(3)(i)(A). These facts must be disclosed on
2 Form 8886, a “Reportable Transaction Disclosure Statement.” *Id.*
3 § 1.6011-4(a), (d). The information provided on Form 8886 must
4 “describe the expected tax treatment and all potential tax benefits
5 expected to result from the transaction, describe any tax result
6 protection . . . with respect to the transaction, and identify and
7 describe the transaction in sufficient detail for the IRS to be able to
8 understand the tax structure of the reportable transaction.” *Id.*
9 § 1.6011-4(d).

10 The Commissioner determined that the increased thirty-
11 percent penalty under § 6662A(c) applied to the Clinic because its
12 understatement was attributable to a listed transaction, and the
13 Clinic did not disclose the relevant facts affecting the Benistar Plan’s
14 tax treatment on Form 8886. We agree with the Commissioner’s
15 determination. The parties stipulated that the Clinic did not disclose
16 its participation in, or the facts surrounding its participation in, the

1 Benistar Plan on Form 8886 or any similar document. Thus, the
2 Clinic is liable for the increased thirty-percent penalty rate under
3 § 6662A(c) for failing to make such disclosures.

4 **IV. Fair Warning**

5 Petitioners also argue that they had no “fair warning” of
6 accuracy-related penalties under § 6662A because the section is
7 unclear and the application of § 6662A in the context of the Benistar
8 Plan is difficult to understand. We disagree.

9 Due process “requires that before a[n] . . . administrative
10 penalty attaches, an individual must have fair warning of the
11 conduct prohibited by the statute or the regulation that makes such
12 a sanction possible.” *Cnty. of Suffolk v. First Am. Real Estate Solutions*,
13 261 F.3d 179, 195 (2d Cir. 2001). In the context of administrative
14 penalties for failure to pay a tax, the Due Process Clause’s fair
15 warning requirement “is satisfied through the notice provided by
16 the statute that establishes the obligation to pay” the underlying tax.

1 *Id.*; cf. *United States v. Mfrs. Nat'l Bank of Detroit*, 363 U.S. 194, 200
2 (1960) (explaining that IRS “regulations gave the insured fair notice
3 of the likely tax consequences” of a taxable event).

4 Notice 95-34 was promulgated in June 1995, *see* I.R.S. Notice
5 95-34, 1995-1 C.B. 309, and the transaction identified by Notice 95-34
6 was formally classified as a “listed” tax-avoidance transaction in
7 March 2000, *see* I.R.S. Notice 2000-15, 2000-1 C.B. 826. Penalties
8 under § 6662A were enacted on October 22, 2004, and made effective
9 for tax years ending after that date. *See* American Jobs Creation Act
10 of 2004, Pub. L. No. 108-357, § 812(f), 118 Stat. 1418, 1580. Section
11 6707A, which defines a listed transaction as one that is “substantially
12 similar to” a tax-avoidance transaction, was also enacted on October
13 22, 2004. *See id.* § 811, 118 Stat. at 1575. The IRS regulation defining
14 “substantially similar” as “factually similar [to] or based on the same
15 or similar tax strategy” was promulgated on March 4, 2003. *See*
16 Treas. Reg. § 1.6011-4(c)(4) (as amended in 2010); Tax Shelter

1 Regulations, 68 Fed. Reg. 10,161, 10,167 (Mar. 4, 2003). Disclosures
2 of listed transactions on Form 8886 were required beginning March
3 4, 2003, as well. See Treas. Reg. § 1.6011-4(d) (as amended in 2010);
4 Tax Shelter Regulations, 68 Fed. Reg. at 10,168. Finally, the relevant
5 tax years in this case ended on December 31, 2004, for the Prossers,
6 and March 31, 2005, for the Clinic.

7 Because the relevant statutes and regulations, as well as
8 Notice 95-34, were all in effect prior to the end of the tax years at
9 issue, we hold that Petitioners had adequate notice of accuracy-
10 related penalties under § 6662A. “The principle that ignorance of
11 the law is no defense applies whether the law be a statute or a duly
12 promulgated and published regulation.” *United States v. Int’l*
13 *Minerals & Chem. Corp.*, 402 U.S. 558, 563 (1971). To the extent
14 Petitioners attempt to rely on a legal opinion letter asserting that the
15 Benistar Plan qualifies as a proper § 419A(f)(6) multiple-employer
16 benefit fund, we explained in *Curcio* that the law firm’s letter “made

1 no guarantees as to the deductibility of Plan contributions.” *Curcio*,
2 689 F.3d at 229. Indeed, “the letters specifically warned” Petitioners
3 that Benistar Plan contributions may not be deductible. *Id.*

4 While *this Court* has not previously held that the Benistar Plan
5 was “substantially similar” to a listed tax-avoidance transaction, this
6 is not a case resolving ambiguous statutory language. None of the
7 relevant provisions in I.R.C. §§ 419, 419A, 6662A, 6664, or 6707A, or
8 Notice 95-34 are unclear or difficult to apply. When it is clear that a
9 transaction is substantially similar to a listed tax-avoidance
10 transaction under the I.R.C. and IRS regulations, participants have
11 fair warning of § 6662A penalties even if a court has not held the
12 transaction to be substantially similar to a listed transaction.

13 **V. The Commissioner’s Burden of Proof**

14 Finally, Petitioners argue that for the reasons set forth in their
15 brief, the Commissioner failed to meet his burden of proof to
16 demonstrate that § 6662A penalties were appropriate. The IRS has

1 “the burden of production in any court proceeding with respect to
2 the liability of any individual for any [tax] penalty.” I.R.C. § 7491(c).
3 For the reasons set forth in this opinion, we hold that the
4 Commissioner met his burden of proof.

5 CONCLUSION

6 For the foregoing reasons, we hold that the Benistar Plan is
7 substantially similar to the listed tax-avoidance transaction
8 identified by the IRS in Notice 95-34. We therefore uphold the
9 Commissioner’s assessment of accuracy-related penalties against the
10 Prossers and the Clinic under I.R.C. § 6662A. We also hold that
11 Petitioners had adequate notice of the potential for penalties under
12 § 6662A and that the increased penalty rate under § 6662A(c) applies
13 to the Clinic. Accordingly, we **AFFIRM** the decisions of the Tax
14 Court.