wealthy taxpayers as a tax avoidance tool.

Jason Bramwell • Aug. 11, 2023

The IRS alerted business owners and tax professionals this week about a variety of compliance issues, including abusive tax schemes, that can be associated with employee stock ownership plans (ESOPs).

"The IRS is focusing on this transaction as part of the effort to ensure our tax laws are applied fairly and high-income filers pay the taxes they owe," IRS Commissioner Danny Werfel said in an Aug. 9 press release. "This means spotting aggressive tax claims as they emerge and warning taxpayers. Businesses and individual taxpayers should seek advice from an independent and trusted tax professional instead of

that includes alerting higher-income taxpayers and businesses to compliance issues and aggressive schemes involving complex or questionable transactions, including those involving ESOPs."

ESOPs are retirement plans that allow employees to own stock in their employer's company. Any company that has stock can sponsor an ESOP for its employees as long as the ESOP invests primarily in the securities of the employer. ESOPs can be complex arrangements, the IRS said, because the ESOP can borrow funds from the employer or a third party to purchase shares of the company.

During its current compliance efforts, the IRS stated it has spotted numerous issues, such as:

- Valuation issues with employee stock;
- Prohibited allocation of shares to disqualified persons; and
- Failure to follow tax law requirements for ESOP loans causing the loan to be a prohibited transaction.

The IRS also said it has seen promoted arrangements using ESOPs that are potentially abusive. For instance, schemes where a business creates a "management" S corporation whose stock is wholly owned by an ESOP for the sole purpose of diverting taxable business income to the ESOP. The S corporation pretends to provide loans to the business owners in the amount of the business income to avoid taxation of that income.

The IRS said it disagrees with how taxpayers interpret this transaction and emphasizes that these purported loans should be taxable income to the business owners. These transactions also impact whether the ESOP satisfies several tax law requirements that could result in the management company losing its S corporation status, the IRS added.

Over the next 12 months, the IRS said it will continue to use a range of compliance

(NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors.