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Tax Shelters

KPMG Verdict Shows IRS Will Use Criminal Courts to Combat Fraud, Lawyers Say

NEW YORK—A U.S. district court verdict regarding alleged abusive tax shelters sent a message to practitioners that the Justice Department will not hesitate to launch criminal proceedings against perceived illegal tax fraud, tax practitioners told BNA Dec. 18 and 19.

And while some former government lawyers said they were disappointed the jury acquitted defendants on conspiracy charges, they and other tax lawyers said guilty verdicts on numerous tax evasion charges in the case demonstrated to practitioners the possibility of going to jail for assisting clients engage in illegal tax transactions.

The U.S. District Court for Southern District of New York jury Dec. 17 convicted three tax professionals on criminal tax evasion charges related to the marketing and selling of transactions in the late 1990s that the government claimed were illegal tax shelters. But it also acquitted a fourth professional on each of the five counts brought against him, and it acquitted defendants of a conspiracy charge, as well.

While practitioners labeled the verdict as "mixed" and said the government may have made strategic errors regarding certain elements of the case, virtually all practitioners contacted for this report agreed the verdict demonstrated the government can assert criminal charges against practitioners and gain convictions.

"The stakes are higher than people might have thought in the late 1990s when [the marketing of the transactions] was happening," Sideman & Bancroft LLP partner Wendy Abkin told BNA Dec. 19. "For people who are over the line or uncomfortably close to the line and perhaps not sure of what side of the line they're on, I think they have to take the verdict into consideration."

Jury Verdict.

The jury voted to convict former KPMG LLP senior tax manager John Larson and former KPMG tax partner Robert Pfaff on 12 counts of tax evasion in the closely watched case (243 DTR K-2, 12/18/08). Former Brown & Wood LLP partner Raymond (R.J.) Ruble, who wrote opinion letters concerning allegedly illegal transactions, was convicted on 10 counts of tax evasion.

But the jury acquitted former KPMG tax partner David Greenberg on five counts of tax evasion. Larson, Pfaff, and Ruble were found not guilty of conspiracy to defraud the U.S. government.

The jury's rejection of the conspiracy charge but vote to convict on the substantive tax evasion charges highlights the government's difficulty in asserting the criminality of aggressive tax strategies that depend, in large part, on their economic substance, McDermott Will & Emery LLP partner Douglas Whitney told BNA Dec. 18.

That jurors did not convict on the conspiracy charge seemed to indicate that while they concluded the three convicted defendants evaded tax obligations in specific instances, the transactions themselves were not unlawful, Whitney said.

The verdict, thus, demonstrated that merely pursuing an aggressive strategy may not be viewed as unlawful and should not be the subject of criminal proceedings absent specific and intentional acts to misrepresent or conceal facts from the government, Whitney said.

Impact on Economic Substance Doctrine.

The verdict may also bolster IRS's opposition to codify the economic substance doctrine into statutory law, preferring the flexibility that different courtrooms and varying facts and circumstances may provide to prosecutors. IRS, instead, will likely try to continue leveraging the unclear nature of the doctrine and adapt their strategies if it is not a code based doctrine, Whitney said.

But he also said the acquittals highlighted a limit to which the government may rely on the economic substance doctrine as a prosecutorial tool. "I think [the conspiracy acquittals and Greenberg's acquittal] send a pretty strong message to the government that the criminal courtroom is not the place to try to define the elusive contours of the economic substance doctrine," said Whitney, who has represented numerous individuals and entities in IRS investigation and enforcement actions relating to allegedly abusive tax shelters.

Virtually all the practitioners interviewed said the verdict demonstrated the IRS's very public attack against abusive tax shelters has been effective.

One practitioner, who declined to be identified because of client sensitivities, said IRS has "certainly has had success" in battling abusive tax shelters. "The shelter war has largely been won by the government. I don't think there is any doubt about that," the practitioner said.

A related development which has recently impacted the profession is enhancement of return preparer penalties, said Abkin, a tax controversy specialist based in San Francisco.

Lessons for Government ?

Indeed, practitioners said that barring statute limitations, the government—armed with the KPMG verdict—may elect to pursue other cases similar to the KPMG case. But others disagreed to a degree, saying the KPMG case never lived up to the government's contention that the case was a major tax fraud initiative that would have lasting effects on the tax practitioner community.

"I don't see a pronounced effect from this," Whitney said. But individuals and taxpayers could take some comfort from the verdicts, which counsel against trying to criminalize tax strategies absent specific and intentional acts of misrepresentation or concealment, he said.

But Whitney said the verdict may shape prosecutors' approach to other tax fraud cases, such as a case currently in the U.S. District Court for the Southern District of New York alleging tax shelter fraud against former Ernst & Young tax professionals (*United States v. Coplan*, S.D.N.Y., (S1) 07-cr453, 2/19/08) (34 DTR K-1, 2/21/08).

But in the end, "[t]ax professionals are likely continuing to plan to assist their clients minimize taxes," Hochman Salkin Rettig Toscher & Perez PC principal Charles Rettig said in a Dec. 18 statement. "It may be professional malpractice for a tax professional to refrain from advising a client about a 'legal tax shelter.' ... Should tax professionals fail to maximize tax benefits for their clients?"

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