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Ernst & Young's \$123M Non-Prosecution Agreement Over Tax Shelters: Priceless

Ernst & Young should be simultaneously breathing a sigh of relief and licking its wounds, wounds that are more than skin deep. The accounting giant agreed to pay \$123 million to the feds to tie off a criminal investigation into the accounting firm's hawking of tax shelters. E&Y may have dodged a bullet compared to Arthur Anderson, the once premier accounting giant that collapsed after the Enron scandal.



But E&Y has admitted to helping wealthy clients avoid more than \$2 billion in taxes with fraudulent tax shelters between 1999 and 2002. The accounting firm also agreed to permanent restrictions on its tax practice. In exchange, E&Y won't be prosecuted. Some of this is simply the other shoe dropping. Back in 2003, E&Y agreed to a \$15 million settlement with the IRS over these shelters, and the firm quietly closed up its tax shelter unit that year.

But the criminal investigation persisted, with prosecutors claiming E&Y's shelters had no economic substance, being solely designed to reduce taxes. E&Y partners and employees produced false documents to keep the

government from uncovering the scam, claimed prosecutors. And now E&Y has admitting wrongdoing, saying that its shelter activities represented “an isolated period in the firm’s long history of providing ethical and professional tax services.”

In fact, four former E&Y employees were convicted of criminal charges in 2009 in connection with the scheme. An appeals court threw out two of the convictions based on the sufficiency of the evidence. E&Y isn’t the only accounting firm to face such issues.

In 2005, KPMG LLP agreed to a \$456 million settlement to settle tax-shelter allegations. But in E&Y’s case there is now a non-prosecution agreement and a detailed Statement of Facts in which the firm admits the wrongful conduct of certain of its partners and employees. What’s more, the firm has agreed to permanent restrictions and controls on its tax practice.

These restrictions include a prohibition against planning, promoting or recommending any “[listed transaction](#)” (one the IRS has designated as for tax avoidance). E&Y also agrees to continued cooperation with the Government’s investigation. In exchange, the U.S. agreed not to criminally prosecute the firm.

Yet if E&Y violates its agreement, the U.S. Attorney’s Office can still prosecute. The Statement of Facts says that from 1999 to 2002, E&Y developed, marketed and implemented four tax shelters called COBRA, CDS, CDS Add-On, and PICO. Sold to about 200 high net worth clients, they were to defer, reduce, or eliminate \$2 billion in aggregate tax liabilities. See [Department of Justice Press Release](#). E&Y prepared the tax returns and then defended clients in audits of these transactions.

In reality, though, these were mere shelters marketed to achieve tax savings. The coverup may have been worse than the crime. Some E&Y personnel engaged in a concerted effort not to create, disseminate, or publicize documents reflecting the tax motivation, the statement declares. There were some efforts expended to hide the true character of these deals.

Even into 2003 and 2004, E&Y representatives falsely portrayed the deals in response to IRS [Information Document Requests](#) and in testimony to the IRS. E&Y prepared documents and correspondence that falsely and inaccurately reflected events or conversations. As these new documents reveal, this was a sad era for E&Y and for many professional firms. Its reminders will be around for years to come.

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