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Tax Hits College Admissions Scandal, IRS On Notice

It's almost Tax Day. Unless you've had your head in the sand, it would be hard not to know something about the college admissions scandal. Prosecutors charged 50 people in an alleged scheme to secure spots at top universities by illicit means, from fixing test scores, to faking athletic prowess, to rigging donations. The charges have yet to be proven, but the 33 parents who are charged will have to contend with cooperating witnesses, including the alleged mastermind of the scheme, William Singer. He has already pleaded guilty to counts of racketeering conspiracy, money laundering conspiracy, conspiracy to defraud the United States, and obstruction of justice. How do taxes figure in?

A number of parents were charged with conspiracy to commit mail fraud and honest services mail fraud. Prison time is certainly possible. But the tax elements of the case are now getting some press. This week, U.S. Senate Finance Committee Chairman Chuck Grassley (R-IA) and Ranking Member Ron Wyden (D-OR) called on the IRS Commissioner in this letter to fully enforce the tax laws against those involved. Perhaps Republicans and Democrats can agree on something after all. They outline several types of transactions between parents and the Key Worldwide Foundation to facilitate the illicit payments. These include payments made from private foundations and from businesses for what appear to be personal, illicit benefit, as well as donations of stock arranged to appear as charitable donations. The tax angles are huge, and the potential taxes, penalties and interest seem serious. Criminal tax charges are possible, and they could be serious in themselves.

Members of the media and attendees gather as actress Lori Loughlin, not pictured, exits federal court in Boston, Massachusetts, U.S., on Wednesday, April 3, 2019. Wealthy parents appeared in court as the clock ticks down on plea bargains for their alleged role in the biggest college admissions scam the Justice Department has ever prosecuted. Photographer: Scott Eisen/Bloomberg

The tax law is clear that you can't write off a charitable contribution if it wasn't really a charitable contribution. One way it might not be is if you were paying for services. Another way would be if the charitable entity wasn't really charitable. Still another might be linked to where the money you contributed came from originally. The Senate Finance letter points out that several of the parents involved in the scandal may have misappropriated funds from private foundations over which they have financial control in order to make illicit payments to the Key Worldwide Foundation. There are tight tax law controls over how private foundations spend money, with special restrictions on so-called self-dealing transactions.

But the tax issues don't stop there. An Affidavit in the case alleges that some of the parents paid bribes and other payments from accounts associated with their businesses. For example, the Affidavit describes one defendant father asking the scandal's ringleader, "What are the options for the payment? Can we make it for consulting or whatever from the [K]ey so that I can pay it from the corporate account? [Ringleader] replied that he could make the invoice for business consulting fees, so that [father] could 'write off as an expense.' [Father] replied, 'Awesome!'"

Shortly thereafter, the defendant father's company allegedly wired $100,000 to Key Worldwide Foundation. The Senators say this strongly suggests the payments were not legitimate business expense deductions. Willfulness or knowledge of wrongdoing can be hard for the government to prove in a criminal tax case. But it may be hard to argue that these tax mistakes were unintentional. Then, there is the alleged end-run around capital gain taxes. The Senators point to the Affidavit again, which suggests that some parents made stock donations. Why stock? That way, you get a write-off for the market value of the stock, and don’t have to pay the capital gain tax on the appreciation in the shares. Talk about a double tax benefit! There are many aspects to this case, but taxes could play a large part. And the people involved are likely to be doing some damage control with amended tax returns and disclosures to the IRS and state tax authorities on top of everything else.

This is not legal advice. For tax alerts or tax advice, email me at Wood@WoodLLP.com.