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Advisers: IRS scam jammers missing mark

Liz Skinner

With April 15 looming and thousands of investors sweating over their tax returns, Uncle Sam is using the occasion to drum home a warning about tax scams.

Some advisers, however, say the government is barking up the wrong tree.

“These practices are peanuts, relatively speaking,” says Thomas Zanecchia, an adviser with Wealth Management Consultants Inc. in Denver, which oversees about \$300 million in client assets.

In a series of news releases, the Internal Revenue Service warns taxpayers to avoid about a dozen schemes.

Among the more notorious are schemes that offer to shelter offshore accounts, urge African-Americans to apply for slavery reparations, or propose setting up a phony business so personal expenses can be deducted, the government says.

Enforcement efforts, however, will largely target those who promote tax schemes. Individuals using offshore bank or brokerage accounts who have failed to report income will have a rare opportunity to seek amnesty, if they act by April 15, the government says.

Clear abuse

Mr. Zanecchia says the government would do better to look for big tax cheaters.

He points to recent reports that two top executives at Sprint Corp. of Westwood, Kan., set up accounts that allowed them to avoid paying taxes on \$288 million of on-paper profits through stock options.

Big accounting firms such as New York-based Ernst & Young LLP and KPMG LLP allegedly helped wealthy executives structure the tax-evasion plan, which claimed taxpayers could defer taxes on capital gains profits when they exercised stock options.

“There was just no economic substance for that,” Mr. Zanecchia says. “It’s just an abuse.”

In fact, Ernst & Young is being sued by some of its clients - executives in Florida, New York and North Carolina - who used the shelters.

The Financial Planning Association has informed its members about the IRS amnesty initiative, says Alfred Campos, counsel and assistant director of government relations for the Denver- and Atlanta-based organization.

Thomas A. Muldowney, founder, principal and financial adviser with Savant Capital Management in Rockford, Ill., says his clients regularly approach him with schemes that reinterpret the tax code.

“We tell them the IRS won’t allow you to do in 20 steps what they won’t allow you to

do in one," says Mr. Muldowney, whose firm manages \$340 million.

According to IRS officials, a substantial number of taxpayers are using offshore banks or brokerages to avoid paying U.S. taxes on card purchases.

The cards aren't illegal, but failing to report that the accounts exist suggests tax evasion, because U.S. citizens must pay tax on their worldwide income, officials say.

Financial advisers say there are many legitimate reasons for their clients to have overseas accounts.

For instance, they could live part of the year in other countries or travel frequently to different parts of the world. As such, they would find it easier to have local accounts.

Others have offshore brokerage accounts because they have foreign bond portfolios or are holding gold as an inflation hedge. Some Americans also may use offshore cards because they have poor credit.

Still, the effect on government coffers is undeniable. "Tens of billions of dollars are lost each year through this," acknowledges Mr. Muldowney. "These people are getting the benefits of living in the U.S. but not paying their fair share."

The tax amnesty doesn't last long. Offenders must turn themselves in by April 15 to duck large penalties and prosecution, the IRS says.

Whether errant taxpayers are likely to come forward before the deadline is debatable, however.

"This won't get people to come forward," says Anthony J. Guinta, an adviser and certified public accountant with Atlanta-based Homrich & Berg Inc., which oversees \$480 million in assets.

IRS investigators don't know enough about how these accounts work, and they don't have the manpower or resources to track them down, he says. "The likelihood of the IRS finding someone doing this is slim."

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