



Duke Law Firm, P.C.—in the News

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Announcing ...

J. Richard Duke will be speaking at the *Legalease Conferences*:

Practical Issues in Trust Administration, 19 September 2005, Westin Casuarina Hotel, Grand Cayman; and Practical Issues in Company Administration, 20 September 2005, Westin Casuarina Hotel, Grand Cayman. Practical Issues in Company Administration, 22 September 2005, British Colonial Hilton, Nassau, Bahamas; and Practical Issues in Trust Administration, 23 September 2005, British Colonial Hilton, Nassau, Bahamas:

<http://www.Legalease.co.uk>

Limited Time Offer: To receive a **discount** of \$80 (per day) and \$240 (for both days) off the respective advertised prices, please provide J. Richard Duke's name when making your reservation.

Please see our Web site for the updated Home page and changes to the "About Us" page:

<http://www.assetlaw.com>

A Solution to Avoid Problems Caused by Per Se Corporations

Duke Law Firm does not form a foreign corporation (international business company—IBC) under a law that is classified as a per se corporation under the Treasury Regulations, unless a client is required to do so in order to own property in a particular jurisdiction that has a per se corporation law. See the July 2005 issue of this newsletter, "U.S. Tax Problems Caused by Per Se Corporations."

What if a U.S. person formed a foreign corporation under one of the per se jurisdictions?

A per se IBC cannot file a Form 8832 with respect to a per se IBC. Thus, the election cannot be made to treat the IBC as a disregarded entity (one shareholder) or a foreign partnership (two or more shareholders) causing the following tax disadvantages: (1) capital gains and lower capital gains tax rates are not available; (2) losses on investments cannot be taken until the IBC is liquidated; (3) investments in the U.S. result in a double tax; and (4) the basis of the stock does not step-up to its fair market value at the death of a shareholder. To alleviate these problems, a new IBC can be formed in a jurisdiction that is not on per se list of corporations (under the regulations).

The IBC (under the per se law) is then merged into the new IBC, thereby terminating the per se IBC. This merger is structured in accordance with the F Reorganization provisions of Internal Revenue Code § 368(a)(1)(F) that allows a change of identity of a corporation without income tax consequences. A change of identity includes moving the place of incorporation from one state to another (or, in this case, from one foreign jurisdiction to another foreign jurisdiction).

After the merger, the IBC can file a Form 8832 electing to treat the IBC as a disregarded entity (one shareholder) or as a foreign partnership (two or more shareholders) so that

the following advantages are available: (1) capital gains and lower capital gains tax rates; (2) losses on investments may be taken as a deduction; (3) investments in the U.S. do not result in double taxation; and (4) at the death of a shareholder, the basis in the stock steps-up to its fair market value.

A Form 926 (for transfers of property to a foreign corporation) may be due and a Form 5471 is required to be filed with respect to the investment activities of the IBC formed under the per se law.

Offshore Life Insurance

Life insurance is recommended for most wealthy individuals or families. It is used primarily to provide liquidity to discharge federal estate taxes and other liabilities at death. Life insurance is also used in stock redemption agreements and cross-purchase agreements (buy-sell agreements), and is also used for many other purposes.

Some of the advantages of variable offshore life insurance issued by a foreign insurance carrier include the following:

- **Asset Protection**—A U.S. person who purchases a policy issued by a domestic carrier receives only the protection by state law (of his residence) against claims of creditors. Most states provide little protection. Under several foreign jurisdictions with favorable laws regarding life insurance carriers, in the event of the insolvency or bankruptcy of the carrier, the segregated ac-

Firms must ensure that they do not represent clients or customers who are engaged in money laundering or terrorist financing. Section 352(a) of the USA Patriot Act, which amends 31 U.S.C. Section 5318(h), requires firms to guard against money laundering by establishing anti-money laundering programs, including: development of internal policies, procedures and controls, designation of a compliance officer, ongoing employee training programs, and an independent audit function to test programs.

In addition to obtaining complete financial information, certified copy of driver's license or passport, and proof of residence, among other things, due diligence also includes searching the records for litigation-court actions, bankruptcy filings, criminal records, regulatory filings (regulatory prosecutions or sanctions) and administrative proceedings. Some practitioners use sources such as LexisNexis to provide these searches; however, Duke Law Firm recommends direct searches as opposed to relying on published news media, etc., through a firm such as Kroll Worldwide.
<http://www.krollworldwide.com>

Firms must be aware of and check the Office of Foreign Assets Control (OFAC) of the U.S. Department of Treasury. For the mission of the OFAC, see:
<http://www.treas.gov/offices/enforcement/ofac/>

Understanding Money Laundering
The concept of money laundering consists of three primary cycles:

- pre-washing phase: this phase involves introduction of the proceeds of crime into the financial system;
- washing phase: this second phase involves hiding the proceeds of crime through a variety of financial transactions, usually designed to eliminate the ability to trace the proceeds; and
- recycling phase: this third phase involves the "washed"

funds that provide benefit to the criminal without further taint.

An article from the September 2005 issue of *WORTH—Wealth and Perspective* titled "Consumed with Guilt," states "As terrorists use luxury goods as conduits for money laundering schemes, the industry faces growing scrutiny." The article further states:

Money launderers and terrorists will not be the only ones facing prison time if they run afoul of these [compliance] measures. Noncompliance with anti-terrorism or anti-money laundering regulations by nominally innocent participants in these transactions carries severe criminal penalties well beyond typical civil fines. The fallout from running afoul of the regulations can severely damage an institution's business ... Forward-thinking businesses will try to enhance their reputations through early and comprehensive compliance. Such efforts may carry additional benefits, such as aiding in the marketing of goods and services, and possibly keep property insurance premiums down.

KPMG Partner Indictment Decisions in U.S. Expected Within Days

Published by Tax AnalystsTM

U.S. attorneys are pressuring the U.S. Justice Department's Tax Division to approve the indictments of several former KPMG partners within days, according to sources familiar with the cases.

After a lengthy grand jury investigation of the accounting firm's tax shelter practice, the U.S. Attorney's Office in the Southern District of New York has informed 20 former KPMG partners that federal

prosecutors are requesting permission to seek indictments, according to an August 3 Washington Post article. The government is charging that at least 10 high-level KPMG partners, many with former government experience, conspired to commit tax evasion, according to one lawyer.

The Justice Department's Tax Division must approve criminal tax cases before an indictment can be sought. The investigation subjects have been availing themselves of their conference of right with the Tax Division attorneys, according to several sources familiar with the cases. No individual deals are being discussed, however, said one lawyer.

The prosecutors may be seeking life imprisonment for the former accounting firm partners, according to one lawyer. The sentencing guidelines for the evasion charge call for life imprisonment, and the Justice Department's position is to press for guideline levels in all cases, according to the source.

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Bush Administration Seeks Settlement in KPMG Case, People Say

Aug. 3 (Bloomberg)—The Bush administration has instructed federal prosecutors to seek a settlement with KPMG LLP over its sale of tax shelters to avoid criminal charges that could drive the accounting firm out of business, people familiar with the case said.

The Justice Department in Washington directed David Kelley, the U.S. attorney for the Southern District of New York, to negotiate a deal, said the people, who requested anonymity. One issue is the size of the fine the Big Four firm must pay, with prosecutors demanding as much as \$500 million, the people said.

A settlement that avoids criminal charges would ease concerns in the Justice Department and among securities regulators that KPMG's collapse would eliminate thousands of jobs and reduce the number of major accounting firms to three. Hundreds of large companies would be left, at least temporarily, without an auditor if KPMG disappears.

"KPMG could survive a huge, unprecedented fine," said Paul R. Brown, an accounting professor at New York University's Stern School of Business. "It will position a cloud over this firm for probably 10 years, but it will not put it out of business."

If the talks between Kelley and KPMG break down, the firm could still be indicted, the people familiar with the discussions said. KPMG may face charges it obstructed justice, sold abusive tax shelters to rich clients and misled investigators from the Internal Revenue Service.

KPMG has been negotiating with officials in Washington to help resolve the case, which is being handled out of Kelley's office in Manhattan. The firm acknowledged the threat of an indictment in June and apologized for what it said was unlawful conduct by former partners. Justice Department spokesman Bryan Sierra declined to comment.

Former Partners Prosecutors also have notified as many as 20 ex-KPMG partners that they may face criminal charges for their roles in selling the tax shelters, the Washington Post reported.

Tom Fitzgerald, a spokesman for KPMG, declined to comment on the status of the case. In June, KPMG said it no longer provides questionable tax shelter services and is cooperating with the government. The firm "looks forward to a resolution that recognizes the significant reforms the firm has already made in response to this

matter while appropriately sanctioning the firm for this wrongdoing," the statement said.

Tax shelters are sophisticated investments designed to minimize tax liabilities. Accounting firms and investment banks have traditionally sold the shelters to corporations and wealthy individuals, often including a supporting opinion from a law firm.

The 2002 federal indictment of Arthur Andersen LLP led to the destruction of the accounting firm that once employed 85,000 people worldwide. The Supreme Court on May 31 overturned Andersen's conviction for obstructing a government investigation into Enron Corp., ruling the jury based its verdict on faulty instructions.

The Big Four

The Andersen prosecution reduced the number of major U.S. accounting firms from five to four. The remaining firms—PricewaterhouseCoopers LLP, Ernst & Young LLP, Deloitte & Touche LLP and KPMG -- audit almost all Fortune 500 companies. KPMG, the smallest of the four, has 1,600 partners in the U.S. and reviews the books of more than 1,000 companies.

Prosecutors are pushing KPMG to accept a so-called deferred prosecution agreement that would entail a big fine, behavioral changes and oversight by an independent monitor.

"The Justice Department's issue is do we really want to take this down to the Big Three," said David Gourevitch, a former SEC enforcement lawyer and prosecutor in New York. "Or is there some way short of destroying this company that we can get some comfort that this is not going to be recurring in the future?"

Justice Department officials directed Kelley to seek a deal with KPMG after a June 13 meeting between Deputy Attorney General James Comey and Robert

Bennett, a Washington partner at Skadden, Arps, Slate, Meagher & Flom, people familiar with the meeting said. Bennett, representing KPMG, has since been negotiating directly with Kelley, the people said.

Both Comey and Kelley are leaving the Justice Department within the next few weeks for jobs in the private sector.

Severe Penalties

KPMG has been trying to limit the terms of any deferred prosecution that would leave it exposed to criminal charges if it fails to abide by the deal, the people familiar with the case said.

Along with the size of the fine, both sides are negotiating over the extent of bad conduct that the firm will have to admit, the people said.

That could be a sticking point. KPMG is concerned that an extensive admission would scare some of their clients into finding another auditor, expose the firm and its partners to civil lawsuits and leave it a weaker position competitively, the people said.

Some KPMG partners fear colleagues with close relationships to lucrative clients may quit the firm if they are forced to pay a large penalty, the people said.

There is also a concern that key audit clients may decide to abandon KPMG because of the risk the firm could implode or the stigma associated with a headline-grabbing settlement, according to the people.

Sticking With KPMG

Over the past two months, KPMG has tried to gauge the willingness of company clients to stick with the firm under various potential settlements, one person said.

Timothy Flynn, KPMG's chairman and chief executive, also recently held a conference call with the firm's partners to discuss the ne-

gotiations, warning that a settlement would include a substantial fine, another person said.

The Justice Department's investigation is part of a larger probe into tax shelters marketed by accounting firms, law firms and banks to individual and corporate taxpayers during the 1990s.

To contact the reporters on this story: Robert Schmidt in Washington: rschmidt5@bloomberg.net.

See: http://www.bloomberg.com/apps/news?pid=10000087&sid=awxapH45RJ4o&refer=top_world_news

China and India

The September 2005 issue of WORTH—Wealth and Perspective, devotes a great portion to China and India: "China & India—the Best Ways to Invest in the World's Fastest-Growing Economies." The articles on China are an interesting read, especially one on Singapore titled "An Oasis of Order." This article states about Singapore, among other things, that "A sense of the wild combines with a secure and stable civic setting to make Singapore a haven for overseas executives ... When you deal with the government, they do what they say will do and, as a businessperson, that's what you want." A market expert who travels extensively said to ignore bullish articles on India.

The lead article in The Wall Street Journal, August 10, 2005, is titled "FBI Sees Big Threat From Chinese Spies; Businesses Wonder." Some Chinese individuals who have come to the U.S. primarily to study or work for software companies have been accused of stealing trade secrets, including military secrets. The article reports "The FBI campaign is part of a broader shift in Washington, where more and more policy makers see China's rapid economic rise as a threat to the U.S. both militarily and economically." But some leaders of businesses say that the targeting

of the Chinese will hurt the business relationship with China, including the U.S. dependence on the scientific skill of some of the Chinese that is needed in the U.S.

Another article in the same issue of The Wall Street Journal, at page A9, is titled "Big Foreign Investors Are Courting Bank of China." Those foreign investors include: Royal Bank of Scotland Group PLC (United Kingdom), Temasek Holdings Ltd (investment company owned by the government of Singapore), and the Asian Development Bank (based in Philippines). The Wall Street Journal reports:

China's red-hot economy and burgeoning consumerism have prompted a range of banks to invest in the country's financial-services sector, which is opening up under pledges made to the World Trade Organization. Under terms of its WTO deal, foreign banks will get unrestricted access to China's corporate lending and consumer-banking market, starting at the end of next year. Chinese banks are seeking foreign strategic investors to help them upgrade their technology, including risk-management systems, and to pass on management expertise.

The foreign financial institutions are bidding for access to a potentially huge market and an unusual prize. Bank of China is the mainland's leading foreign-exchange bank, conducting most currency trading for the central bank and other states agencies. In addition, Bank of China has a higher international profile than any other Chinese financial institution, with offices around the world and a Hong

Kong subsidiary listed in that city.

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