



## Duke Law Firm, P.C.—in the News

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#### **Legalease Conferences**

Richard Duke just returned from speaking at the Legalease Conferences in the Cayman Islands

(Sept. 19 and 20) and The Bahamas (Sept. 22 and 23). Richard's thanks go out to Alexandra E. Mandrides, Organizer for Legalease Conferences, as well as Nick Jacob (Partner, Lawrence Graham LLP) and Jim Edmondson (Partner, Farrer & Co), London attorneys who were speakers and chairmen of the conferences. Nick and Jim were outstanding chairmen and speakers, as were the other speakers. Additional Cayman Islands speakers included: Adrian Odell (Attorney, Walkers, Cayman Islands); and Colin Shaw (Principal, Colin Shaw & Co, Cayman Islands). Additional Bahamas speakers included: Christel Sands-Feaste (Higgs & Johnson, Nassau); and Heather Thompson (Partner, Higgs & Johnson, Nassau).

#### **Bastion Life Insurance SPC Limited**

The Web site for Bastion Life is now up and running:  
<http://www.bastionlife.com>

See our February 2005 issue of this newsletter for detailed information regarding Bastion Life:

<http://www.assetlaw.com/news.htm>

#### **U.S. Tax Compliance and Tax Reporting Requirements for Foreign Foundations**

Some Americans are implementing foreign foundations for asset protection purposes. Tax issues and tax compliance/tax reporting requirements arise for U.S. persons who implement or fund a foreign foundation, whether directly or indirectly.

The direct or indirect formation or funding of a foreign foundation with cash or assets by an American requires the tax classification of that foreign foundation. The language of the foundation charter determines the tax classification as either a foreign trust or a foreign corporation for U.S. tax purposes under the Treasury Regulations.

A foreign corporation with passive investments results in substantial negative tax ramifications for Americans. A foreign trust is tax neutral, meaning that all income, gains and losses are taxable to the grantor for federal tax purposes.

The required tax returns and reports for a foreign trust include the following: (1) Form SS-4 (Application for Employer Identification Number); (2) Form 56 (Notice Concerning Fiduciary Relationship); (3) Form 3520 (Department of the Treasury Internal Revenue Service Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts); (4) Form 3520-A (Annual Information Return of Foreign Trust With a U.S. Owner); (5) Form 709 (United States Gift (and Generation-Skipping Transfer) Tax Return); (6) Form 1041 (U.S. Income Tax Return for Estates and Trusts); (7) TD F 90-22.1 (Report of Foreign Bank and Financial Accounts); and (8) Form 1040, Schedule B, Part III (check "yes" for having an interest in or signature or other authority over a foreign financial account and "yes" to receiving a distribution from, or being the grantor of, or transferor to, a foreign trust). Failure to file

the foregoing tax returns and reports may result in severe civil penalties and potential criminal penalties.

The required tax returns for a foreign corporation include the following: (1) Form 926 (Return by a U.S. Transferor of Property to a Foreign Corporation) may be due for the transfer of assets to a foreign corporation; (2) Form 5471 (Information Return of U.S. Persons With Respect To Certain Foreign Corporations); (3) Form 709 (United States Gift (and Generation-Skipping Transfer) Tax Return) for transfers to a foundation that includes persons other than the founder as beneficiaries; (4) TD F 90-22.1 (Report of Foreign Bank and Financial Accounts); and (5) Form 1040, Schedule B, Part III (check "yes" for having an interest in or a signature or other authority over a financial account in a foreign country). Severe civil penalties and potential criminal penalties result from failure to file the foregoing returns.

A foreign corporation with passive investment income includes the following negative tax consequences: (1) no capital gains with lower tax rates are available; (2) no losses can be taken with respect to investments until the corporation is liquidated; (3) investments in the U.S. are subject to 30% withholding tax on the earnings, followed by taxation of the remaining earnings under subpart F of the Internal Revenue Code, whether the income is distributed; and (4) the basis of the stock (interest in the foundation) does not step-up to its fair market value upon the death of the founder. All income, gains and losses of a foreign trust are taxable to the founder (as grantor), whether or not the income is distributed.

Americans failing to classify foreign foundations for tax purposes apparently are not filing required tax returns. Those who

find themselves in such a position must file for all years that the foundation has been in existence. Such Americans who attempt to either liquidate the foundation or transfer the assets to another entity or trust may be walking into a more serious crime than tax fraud and tax evasion; namely, money laundering.

The 1986 Money Laundering Control Act (Act) requires some underlying stated crime (predicate offense) to be committed before any transfer that attempts to wash or hide the money constitutes the crime of money laundering. The Act refers to the Racketeer Influenced and Corrupt Organizations (RICO) Act that includes wire fraud, mail fraud and other means of transferring money or assets across country lines as a predicate offense. The attempt to get rid of the foreign foundation where tax classification has not occurred and required tax returns have not been filed may cause the American to face violation of Money Laundering Control Act.

#### **Outsourcing to India**

The Wednesday, September 28, 2005 issue of The Wall Street Journal, page B1, includes an article titled "More U.S. Legal Work Moves to India's Low-Cost Lawyers." The article begins with: "It happened with tech support, financial services and catalog ordering. Now, a growing number of U.S. and British companies as well as law firms are outsourcing legal work to India."

The article states that "increasingly, squads of experienced but inexpensive lawyers based in India are doing things ranging from patent applications to divorce papers to legal research for Western clients." The article further states that "Indian lawyers don't need much additional training to do standard legal work, such as vetting contracts, checking on patent registrations or reviewing documents related to foreign cases

... American law firms also hire legal outsourcing companies to comb through evidence and documents from past court cases, highlighting what is important and relevant."

Outsourcing does not result in a foreign lawyer, such as an Indian lawyer, representing U.S. clients directly. Only a lawyer licensed in a state in the U.S. can provide legal advice to U.S. clients.

#### **Relying Upon the Advice of Foreign Practitioners**

American lawyers who are engaged in cross-border work (between the U.S. and another jurisdiction) are not qualified to give legal and tax advice regarding the laws of another country. An American lawyer must associate lawyers from foreign jurisdictions who work on cross-border transactions.



Likewise, an American cannot rely upon the advice of an unqualified foreign practitioner, or one who is not licensed to practice law in one or more states in the U.S. This is especially true for U.S. tax advice and ensuring that all tax compliance/tax reporting requirements are met.

#### **Delaware Captive Insurance**

Wilmington, DE, August 25, 2005 – At a ceremonial bill signing held on Monday, August 22, 2005, the Delaware Captive Insurance Association (DCIA) commended the Delaware General Assembly and Delaware Governor Ruth Ann Minner for the recent passage of House Bill 218, which amends the state's legislation relating to captive insurance companies.

Enacted on July 12, the Delaware Revised Captive Insurance Company Act was a collaborative, bipartisan effort of the Offices of the Governor, the Secretary of State, and the Insurance Commissioner of the State of Delaware, along with Delaware lawmakers and private sector groups. It was sponsored by Representative Donna Stone (R – Dover South) and State Senator Patricia Blevins (D – Elsmere), who chair the Senate and House Insurance Committee, and was supported by Insurance Commissioner Matt Denn.

The Delaware Revised Captive Insurance Company Act substantially rewrites the state's original captive insurance company statute, which has been in effect since 1984. Its objective is to encourage the formation of new captive insurance companies – known as captives – in Delaware, thereby bringing the state new business, tax revenue, and jobs.

See: <http://www.state.de.us/corp/DelawareCaptiveInsurance9-1-05.shtml>

### **Tax Inquiry is Moving Past KPMG—Banks and Other Linked to Shelters**

*New York Times, Friday, Sept. 16, 2005*

This article states that federal prosecutors are widening their criminal investigation to roles played by banks, financial advisers and law firms, as well as other accounting firms that worked with KPMG and its tax shelters. This article states that twelve wealthy investors filed for law suit in a Texas State court in Fort Worth contending that one Duetsche Bank employee contacted the law firm of Jenkins & Gilchrist regarding creating a high aggressive tax shelter using options on foreign currencies. That shelter later became known as Cobra. The article further states that the heart of this law suit in Texas with respect to Cobra was sold by Ernst & Young.

### **KPMG Target of Class Action Suit for Sale of SC2 Strategy**

*Published by Tax AnalystsTM*

Shelter investors who purchased the S corporation charitable contribution (SC2) strategy from KPMG LLP have filed a class action complaint against the firm in the U.S. District Court for the Southern District of New York.

Roger Heumann and Gilman Sentry Photo Inc. filed the complaint against KPMG on behalf of shelter investors who purchased SC2 from the firm from 1998 through 2003.

The complaint alleges that KPMG provided an opinion letter to investors that said it was "more likely than not" that the strategy would be approved by the IRS.

"KPMG had knowledge, which it recklessly disregarded, that SC2 was an unlawful tax shelter that should have been, but was not, registered with the IRS, and was not 'more likely than not' to be approved by the IRS if discovered," the complaint says.

The complaint also says class members have faced audits of their state and federal tax returns and have been or will be assessed millions of dollars in back taxes, interest, and penalties.

SC2 transactions were first exposed as potentially abusive tax shelters by the minority staff of the Senate Government Affairs Permanent Subcommittee on Investigations during its November 2003 hearings, and the IRS named SC2 a listed transaction on April 1, 2004.

Allegedly mass-marketed by KPMG, SC2 transactions were accomplished by establishing S corporations for clients who later donated stock from those corporations (or promised to make future donations) to charitable organi-

zations that are not subject to unrelated business income tax.

According to an investigation report prepared by the minority subcommittee staff, SC2 was a tax shelter strategy intended to generate a tax-deductible charitable donation for the corporate owner and, more importantly, to defer and reduce taxation of a substantial portion of the income produced by the S corporation, essentially by "allocating" but not actually distributing that income to a tax-exempt charity holding the corporation's stock.

*Document: (Doc 2005-16975)*

*Electronic Citation: See 2005 TNT 153-11*

### **KPMG to Pay \$456 Million for Criminal Violations**

(Statement by IRS Commissioner Mark W. Everson) *IR-2005-83, Aug. 29, 2005* [in part]

WASHINGTON — KPMG LLP (KPMG) has admitted to criminal wrongdoing and agreed to pay \$456 million in fines, restitution and penalties as part of an agreement to defer prosecution of the firm, the Justice Department and the Internal Revenue Service announced today.

In addition to the agreement, nine individuals—including six former KPMG partners and the former deputy chairman of the firm—are being criminally prosecuted in relation to the multi-billion dollar criminal tax fraud conspiracy. As alleged in a series of charging documents unsealed today, the fraud relates to the design, marketing, and implementation of fraudulent tax shelters.

In the largest criminal tax case ever filed, KPMG has admitted that it engaged in a fraud that generated at least \$11 billion dollars in phony tax losses which, according to court papers, cost the United States at least \$2.5 billion dollars in evaded taxes. In addition to KPMG's former deputy chairman, the individuals indicted today

include two former heads of KPMG's tax practice and a former tax partner in the New York, NY office of a prominent national law firm.

KPMG also admitted that its personnel took specific deliberate steps to conceal the existence of the shelters from the IRS by, among other things, failing to register the shelters with the IRS as required by law; fraudulently concealing the shelter losses and income on tax returns; and attempting to hide the shelters using sham attorney-client privilege claims.

The agreement provides that prosecution of the criminal charge against KPMG will be deferred until Dec. 31, 2006 if specified conditions—including payment of the \$456 million in fines, restitution, and penalties—are met. The \$456 million penalty includes: \$100 million in civil fines for failure to register the tax shelters with the IRS; \$128 million in criminal fines representing disgorgement of fees earned by KPMG on the four shelters; and \$228 million in criminal restitution representing lost taxes to the IRS as a result of KPMG's intransigence in turning over documents and information to the IRS that caused the statute of limitations to run. If KPMG has fully complied with all the terms of the deferred prosecution agreement at the end of the deferral period, the government will dismiss the criminal information.

To date, the IRS has collected more than \$3.7 billion from taxpayers who voluntarily participated in a parallel civil global settlement initiative called Son of Boss. The BLIPS and SOS shelters are part of the Son of Boss family of tax shelters.

The agreement requires permanent restrictions on KPMG's tax practice, including the termination of two practice areas, one of which provides tax advice to wealthy

individuals; and permanent adherence to higher tax practice standards regarding the issuance of certain tax opinions and the preparation of tax returns. In addition, the agreement bans KPMG's involvement with any pre-packaged tax products and restricts KPMG's acceptance of fees not based on hourly rates. The agreement also requires KPMG to implement and maintain an effective compliance and ethics program; to install an independent, government-appointed monitor who will oversee KPMG's compliance with the deferred prosecution agreement for a three-year period; and its full and truthful cooperation in the pending criminal investigation, including the voluntary provision of information and documents.

### **Governments Aggressively Targeting Offshore Tax Shelters, Practitioners Say at an International Bar Association Conference Held in Prague**

*by Cordia Scott, Sept. 29, 2005  
Published by Tax AnalystsTM*

At this meeting, lawyers stated that there is an increasing international crackdown on increasingly sophisticated offshore tax shelters. "There are more undercover operations that are ongoing ... [and] more special agents at the [U.S. Internal Revenue Service] are going undercover overseas," said Justin Thornton of the Law Offices of Justin Thornton in Washington. A former U.S. Justice Department trial attorney, Thornton now works as a criminal defense attorney and is currently representing one of the KPMG partners being prosecuted in the United States.

Thornton also stated that "One of the sobering consequences of this effort is that tax advisers now are more personally at risk than ever, he said, pointing to the ongoing KPMG case."

### **Tax Evasion Soaring Among Brazilian Companies, Study Shows**

*Published by Tax AnalystsTM*

A recent study by the Brazilian Institute of Tax Planning (IBPT) indicates that tax evasion among Brazilian companies has grown considerably in the past few years. According to the IBPT, 29.45 percent of the 7,437 companies surveyed showed strong evidence of tax evasion in 2004. The percentage was 27.53 in 2002.

The study estimates that Brazilian corporate taxpayers evaded BRL 1.028 trillion (approximately US \$422 billion) in taxes during 2004, an increase of more than 37 percent over 2003.

*Document: (Doc 2005-17792)*

*Electronic Citation: See 2005 WTD 165-5*

### **View on U.S. Turns Bearish**

The Wednesday, September 28, 2005 issue of The Wall Street Journal, page D3, includes an article titled "Money Managers Look Abroad as View on U.S. Turns Bearish." This article states that "Money managers are more bullish on international equity markets and increasingly bearish on U.S. stocks, bonds, real estate and consumer-goods concerns ..."

### **ABA Nominates LL.M. Program for the 2005 Diversity Award**

*IBLS Monthly Newsletter August 2005  
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Congratulations - The ABA has nominated the Diamond LL.M. Program for the Diversity Award for 2005!!!

The program has a diverse, cross-disciplined international student body, admitting lawyers, accountants, estate planners, trust officers, and economists, learning solo and in groups. The LL.M. program is multi-cultural, with on-line students from Hong Kong, South Africa, Russia, Brazil, United Kingdom, Italy, Mauritius, Canada, Switzerland, The Bahamas, Belize,

USA, China, and many other countries.

For this LL.M. Program, IBLs has created Specialization in E-Commerce Law, including the syllabus, the content for courses and module program, and provides the professors to teach the courses.

E-Commerce LL.M. Courses:

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To learn more about the Diamond LL.M. Program please call 305-668-3260 or go to:

<http://www.llmprogram.org/>

To inquire about E-Commerce Law courses please e-mail

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or call 949-756-0906.

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### Upcoming Conferences/Seminars

J. Richard Duke will be speaking on Asset Protection at the **Rochdale Offshore Investment Management Seminar**, "Asset Protection: How to Protect and Preserve Your Personal Assets and Family Wealth Through Offshore Planning and Investing Strategies," Oct. 18, 2005, 7:30-10:30 am, Westin Hotels & Resorts, 601 South College Street, Charlotte, NC, 28202:

<http://www.rochdale.com/>

Anyone interested in receiving a brochure about this conference may contact Duke Law Firm: [Julie@assetlaw.com](mailto:Julie@assetlaw.com) or Rochdale Offshore Investments:

<http://www.rochdale.com/>

J. Richard Duke will be speaking on International Estate Planning at the **Chartered Wealth Manager Course**, Nov. 4-6, 2005, Yale Club, New York, NY:

<http://mfsfinancial.com/bsiexecutiveeducation/id32.html>

J. Richard Duke will also be speaking on "U.S. Update" at the **12th Annual International Trust Conference**, Jersey (Channel Islands) Society of Trusts & Estates Practitioners (STEP), Friday, November 25, 2005, at the Pomme D'or Hotel, Jersey, Channel Islands